

REFORMING OHIO CORPORATE LAW AND SECURITIES REGULATION TO FACILITATE INVESTMENT IN OHIO

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Against a backdrop of theoretical and empirical evidence, this article explains why and how the Ohio General Assembly should reform Ohio corporate law and securities regulation. As a foundation, theoretical and empirical evidence explains why reforming Ohio corporate law will facilitate investment in Ohio, including data showing that Ohio corporate law raises the cost of capital to Ohio firms. Further demonstrating that capital markets disfavor Ohio corporate law, Abercrombie & Fitch Co. failed in its recent attempt to reincorporate in Ohio.

This article next analyzes Ohio Revised Code sections to specifically explain how clear corporate law implementing non-extreme policy decisions in a straightforward manner can remedy the complexity and extremity that are the hallmarks of Ohio corporate law. Following the statutory analysis, this article refutes objections to reforming Ohio corporate law. This article then concludes with a call for the Ohio General Assembly to reform Ohio corporate law and securities regulation to encourage firms located in Ohio to incorporate in Ohio.

I. INTRODUCTION

The Ohio General Assembly should revise Ohio corporate law and securities regulation to facilitate investment in Ohio. Ohio has tremendous potential to improve its legal environment to benefit businesses and investors. Presently, however, corporate governance under Ohio law is not

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attractive to businesses and investors due to statutory complexity and policy that leading scholars have “blacklisted as extreme.”¹

Abercrombie & Fitch Co.’s recent attempt to reincorporate in Ohio is strong evidence that Ohio should reform its corporate law.² The reincorporation attempt began when Abercrombie, a Delaware corporation with its home office in New Albany, Ohio, filed a proxy statement regarding reincorporation in Ohio in a way that appeared to evade public attention.³ Abercrombie filed the proxy statement on December 22, 2010, during the busy holiday season.⁴ In addition, the proxy statement curiously purported to seek reincorporation because of benefits that were either immaterial or already available to Abercrombie under Delaware law.⁵ Moreover, Abercrombie did not file a press release when it filed its proxy statement.⁶ By some accounts, Abercrombie’s management even failed to respond to media inquiries about the proposed reincorporation.⁷

These actions gave rise to speculation that Abercrombie’s management desired to reincorporate under Ohio law in preparation for a management

¹ Lucian Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 387 (2003) (citing Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843 (1993) and Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001)) (identifying Pennsylvania and Ohio as states with corporate law that has been “blacklisted as extreme” because it excessively protects management)); see also Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1801 (2002) (identifying Ohio, Pennsylvania and Massachusetts as states with corporate law that is extreme).

² See Steven Davidoff, *A Long Weekend, and a Long List of News*, N.Y. TIMES DEALBOOK (Feb. 18, 2011, 6:49 PM), <http://dealbook.nytimes.com/2011/02/18/a-long-weekend-and-a-long-list-of-news/> (“We are about to have a field experiment to see what these institutions think of Ohio law, whether I have overstated the case and whether these shareholders agree with Glass Lewis and Abercrombie.”).

³ Abercrombie & Fitch Co., Proxy Statement (Schedule 14(a)) (Dec. 22, 2010).

⁴ Steven Davidoff, *Abercrombie’s Ohio Express*, N.Y. TIMES DEALBOOK (Dec. 23, 2010, 4:06 PM), <http://dealbook.nytimes.com/2010/12/23/abercrombies-ohio-express/>.

⁵ *Id.*

⁶ *Id.*

⁷ Steven Davidoff, *The Next Stop on Abercrombie’s Ohio Express*, N.Y. TIMES DEALBOOK (Feb. 3, 2011, 1:41 PM), <http://dealbook.nytimes.com/2011/02/03/the-next-stop-on-abercrombies-ohio-express/>; Ken MacFayden, *Abercrombie Addresses MBO Talk*, MERGERS & ACQUISITIONS (Feb. 22, 2011), <http://www.themiddlemarket.com/news/abercrombie-addresses-mbo-talk-216538-1.html?ET=mergersunleashed:e8178:247108a:&st=email> (stating that a call to Abercrombie was not returned to the author by press time).

buyout or to obtain a preferred acquirer without disclosing the scheme.⁸ In light of the complexity of Ohio law, some suspected that the market might overlook this potential purpose for reincorporation.⁹ Indeed, Ohio corporate law is so complex that experienced practitioners disagree about its nature.¹⁰ Nationally recognized proxy advisory firms even disagreed about how Ohio corporate law would impact Abercrombie's proposed reincorporation.¹¹

Underlying the management-buyout theory is extreme Ohio corporate law that gives management nearly unbridled discretion in corporate governance¹² and protects management against takeovers to make such a

⁸ Davidoff, *supra* note 4; see also KERRISDALE CAPITAL MGMT., *The Real Reason Behind Abercrombie's Reincorporation in Ohio*, SEEKING ALPHA (Jan. 19, 2011), <http://seekingalpha.com/article/247374-the-real-reason-behind-abercrombie-s-reincorporation-in-ohio>.

⁹ Davidoff, *supra* note 4 ("This is the time of year when news is announced in the hope that no one will notice. You can't help but think that this was Abercrombie & Fitch's intention with its filing on Wednesday."). Theoretically, public markets incorporate all available information according to the Efficient Capital Market Hypothesis (ECMH). The most common form of the ECMH is the semi-strong theory. Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 383 & n.1 (1970) (crediting Harry Roberts with distinguishing weak and strong-form efficiency). Fama defines the semi-strong theory to mean that capital markets reflect all information that is "obviously publicly available." *Id.* at 383. In this case, the market confirmed the semi-strong theory because shareholders presumably took public information regarding Ohio corporate law's effect on Abercrombie into account when they rejected reincorporation in Ohio. See also discussion *infra* Part II.B (discussing the efficient market hypothesis); text and accompanying references *infra* note 56 (citing references for the debate on market efficiency and shareholder primacy).

¹⁰ Compare David P. Porter, *Competing with Delaware: Recent Amendments to Ohio's Corporate Statutes*, 40 AKRON L. REV. 175, 185 (2007) (stating that there are fundamental differences between Ohio and Delaware law, as well as technical differences in which Ohio has renounced specific legal doctrines developed in the Delaware Court of Chancery), with Tim Feran, *Abercrombie Responds to Critic of its Plan to Reincorporate in Ohio*, COLUMBUS DISPATCH, Feb. 23, 2011, <http://www.dispatch.com/live/content/business/stories/2011/02/23/abercrombie-responds-to-critic-of-reincorporation-move.html> ("But the fact is, Ohio law isn't drastically different from Delaware law—except for the fact that it's certain." (quoting practitioner John Beavers)).

¹¹ Davidoff, *supra* note 2 (comparing the Institutional Shareholder Services (ISS) Report for Abercrombie & Fitch, Co.'s Feb. 28, 2011 proxy vote, which states: "[t]he proposed reincorporation is not in the best interests of shareholders because Ohio's takeover defenses and director liability provisions would represent a diminution in shareholder rights," with the competing Glass Lewis report that finds Ohio law incidental and recommends an affirmative shareholder vote).

¹² Under Ohio law, there is effectively no fiduciary duty of care, which gives management discretion in choosing a potential acquirer. See OHIO REV. CODE ANN.

plan plausible.¹³ In fact, proxy advisory firm Institutional Shareholder Services (ISS) cited director discretion under Ohio corporate law as the primary factor for recommending that shareholders reject the reincorporation proposal.¹⁴ The shareholder vote scheduled for February 2011 was postponed indefinitely because Abercrombie did not have enough shareholder support to reincorporate in Ohio.¹⁵ Later, in July 2012, Abercrombie announced a large stock buyback,¹⁶ which further suggests that Abercrombie's management views its shares as undervalued and may have intended to buy out shareholders under Ohio law.

Abercrombie's experience shows that Ohio corporate law has reached an impasse. In a rare market test, the market, through shareholders, has expressly rejected Ohio corporate law because it limits manager accountability and firm efficiency.¹⁷ Market rejection indicates that agency problems between shareholders and management give rise to excessive costs under Ohio corporate law.¹⁸ Empirical studies also confirm that Ohio

§ 1701.59(F) (West Supp. 2012); discussion *infra* Part IV.A.2. "Management" is a term used here to include corporate officers and members of the board.

¹³ See Davidoff, *supra* note 4; discussion *infra* Part IV.A.3.

¹⁴ ISS PROXY ADVISORY SERVS., *Abercrombie & Fitch Co.: Meeting Date 28 February 2011*, at 1 (Feb. 8, 2011) ("In view of recent acquisition activity among apparel retailers, shareholders should scrutinize any attempt to reincorporate in Ohio. If the company were to reincorporate in Ohio, the directors would have considerably more control over an acquisition, as well as more certainty regarding their own legal protection in such a scenario. While we are not aware of any current discussions regarding a takeover of ANF, the timing of the proposed move and the absence of a compelling rationale for shareholders raise questions as to the board's motives."); *id.* at 4–6 ("On balance, this item does not warrant shareholder support. The board's recent track record raises serious concerns as to the advisability of granting it Ohio's expanded authority and legal protection. At the 2009 and 2010 annual meetings, shareholders sent a strong message to the board that change was needed. The board's response is essentially an offer to trade one poor governance structure for another.).

¹⁵ Tim Feran, *Lack of Strong Support Prompts Abercrombie to Delay Reincorporation Vote*, COLUMBUS DISPATCH, Feb. 28, 2011, <http://www.dispatch.com/live/content/business/stories/2011/02/28/abercrombie-postpones-vote-on-reincorporation.html?sid=101>; see *Abercrombie Not Yet Ready to Be an Ohio Player*, N.Y. TIMES DEALBOOK (Feb. 28, 2011, 9:50 AM), <http://dealbook.nytimes.com/2011/02/28/abercrombie-not-yet-ready-to-be-an-ohio-player/>.

¹⁶ James Covert, *Le Preppy Pe-Yew: Abercrombie to Hike Buyback as Europe Slows*, N.Y. POST, July 11, 2012, http://www.nypost.com/p/news/business/le_preppy_pe_yew_CYG7XhnaYYfeq4aFMwu0PN.

¹⁷ Davidoff, *supra* note 2 (referring to the vote as a "market test"); Proxy Statement, *supra* note 3.

¹⁸ Frank Easterbrook & Daniel Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1170–73 (1981) ("The source of the premium is the reduction in agency costs, which makes the firm's assets worth more in the hands of the acquirer than they were worth in the hands of

corporations have an unnecessarily high cost of capital.¹⁹ In other words, investors in Ohio corporations require a higher interest rate on debt and provide less capital in return for equity because management has little accountability to shareholders. Exacerbating this issue, the rise of institutional investors in recent years has diminished the collective action problem among shareholders, making shareholder interests in balanced corporate law more important.²⁰ Against this background, this article

the firm's managers."); Bruce Kobayashi & Larry Ribstein, *Nevada and the Market for Corporate Law*, 35 SEATTLE U. L. REV. 1165, 1173–74 (2012) (discussing agency costs in state corporate law).

¹⁹ Dale Arthur Oesterle, *Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 911–13 (1988) (defending the methodology of the Ryngaert and Netter study); Michael Ryngaert & Jeffry Netter, *Shareholder Wealth Effects of the Ohio Antitakeover Law*, 4 J.L. ECON. & ORG. 373, 374 (1988) (stating that stock value of Ohio public companies fell 2% following the enactment of Ohio antitakeover legislation in 1986); Michael Ryngaert & Jeffry Netter, *Shareholder Wealth Effects of the 1986 Ohio Antitakeover Law Revisited: Its Real Effects*, 6 J.L. ECON. & ORG. 253 (1990) [hereinafter Ryngaert & Netter, *Revisited*] (persuasively supporting methodology used for their 1986 article). *But see* Donald Margotta, Thomas McWilliams & Victoria McWilliams, *An Analysis of the Stock Price Effect of the 1986 Ohio Takeover Legislation*, 6 J.L. ECON. & ORG. 235 (1990) (critically analyzing the methodology used in the 1986 Ryngaert and Netter article). In addition to the studies on Ohio antitakeover laws, empirical studies regarding extreme corporate law in Pennsylvania yielded similar results. *See* Jonathan M. Karpoff & Paul H. Malatesta, *PA Law: State Antitakeover Laws and Stock Prices*, 46 FIN. ANALYSTS J., July–Aug. 1990, at 8; L. Mick Swartz, *The 1990 Pennsylvania Antitakeover Law: Should Firms Opt Out of Antitakeover Legislation?*, 11 J. ACCT., AUDITING & FIN. 223, 223 (1996) (finding a 9% decrease in shareholder returns following the passage of Pennsylvania antitakeover laws, including a control shareholder acquisition act, although under less ideal circumstances for empirical study than the Ryngaert and Netter Ohio study); Samuel J. Szewczyk & George P. Tsetsekos, *State Intervention in the Market for Corporate Control: The Case of Pennsylvania Senate Bill 1320*, 31 J. FIN. ECON. 3, 19 (1992) (finding statistically significant abnormally low shareholder returns for Pennsylvania firms that did not opt-out of Pennsylvania antitakeover statutes enacted in 1990).

²⁰ D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 131–40 (2011) (discussing the rise of institutional shareholders); *e.g.*, *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1382 (Del. 1995) ("It is generally accepted that proxy contests have re-emerged with renewed significance as a method of acquiring corporate control because 'the growth in institutional investment has reduced the dispersion of share ownership.'" (citing Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1071, 1134 (1990))); *see also* Subramanian, *supra* note 1, at 1861 (stating that management derives less benefit from extremely protective statutes in states like Ohio following the rise of institutional shareholders in the 1990s).

analyzes Ohio corporate law, LLC law and securities regulation with a focus on reforming Ohio law to facilitate investment in Ohio.²¹

II. THEORETICAL UNDERPINNINGS: THE RACE AND STAKEHOLDER DEBATES

Underpinning state corporate law are debates regarding the race to attract corporate charters to a particular jurisdiction and the fundamental role of businesses in society. The race debate and the stakeholder debate are related to one another because corporate law defines shareholder power in a corporation relative to other constituencies (also known as stakeholders), including management, employees, creditors and suppliers, among others.²² In turn, shareholder power affects how management is held accountable for their performance and the attractiveness of state corporate law to a corporation.

Currently, Ohio either does not actively compete for corporate charters or competes under what is known as “the race to the bottom,” which values management interests over firm efficiency.²³ Moreover, Ohio corporate law does not hold shareholder interests, including profit maximization, over other constituencies’ interests.²⁴ Contrary to its current position, Ohio should engage in a limited form of competition for corporate charters to benefit in-state firms with corporate law that holds directors primarily responsible to shareholders.

A. *The Race Debate*

The nature and extent of state competition for corporate law has been subject to vigorous debate. In the United States, corporations may incorporate under (i.e. be created by) any states’ laws regardless of

²¹ See discussion *infra* Parts II–IV. As an important preliminary note, the issues presented herein are non-exhaustive and are intended primarily to provide examples to stress the need to revise Title XVII of the Ohio Revised Code.

²² DALE A. OESTERLE, *THE LAW OF MERGERS AND ACQUISITIONS* 32 (3d ed. 2005) (“The main purposes of corporate law are, first, to legitimize the various transactions and, second, to specify the role shareholders play when there are major changes in their firm’s capital structure.”).

²³ David P. Porter, *Institutional Investors and Their Role in Corporate Governance: Reflections by a “Recovering” Corporate Governance Lawyer*, 59 CASE W. RES. L. REV. 627, 641–43 (2009) (“In contrast [to states including Delaware, Nevada and North Dakota], other states [such as Ohio] focus not on creating a convenient place for foreign incorporators, but to provide a solid foundation for local businesses . . . [Ohio corporate law adopts] statutory provisions that prevent shareholders from having as much control over the corporation as perhaps those holders might like or could theoretically enjoy.”).

²⁴ See OHIO REV. CODE ANN. § 1701.59(F) (West Supp. 2012).

location.²⁵ Under the internal affairs doctrine, firms are governed by the laws of their place of incorporation.²⁶ As a result, states may compete to encourage businesses to incorporate under their laws. Theoretically, states “sell” corporate law, which firms are free to “purchase” in any state.²⁷ Because corporations generally incorporate in their home state or Delaware, competition for state charters does not constitute each state competing against forty-nine others for every firm, but rather home states competing with Delaware for local firms.²⁸ In Ohio, limited competition for firms located in Ohio will increase firm efficiency and lower the cost of capital, and provide other business and governmental advantages.²⁹

Three positions have emerged in the “race debate” to attract corporate charters: the “race to the top,” “the race to the bottom” and a nuanced intermediary approach. Race to the top advocates argue that states will provide corporate law that promotes firm efficiency and enhances shareholder value to compete with one another and attract corporate charters.³⁰ Race to the bottom advocates, on the other hand, argue that states will cater to management interests to attract corporate charters because management heavily influences a firm’s incorporation choice.³¹ In this view, corporate law will value management interests over firm efficiency, which casts doubt upon whether corporate law provisions prevalent among the states are the most efficient to firm performance.³²

²⁵ OESTERLE, *supra* note 22, at 30.

²⁶ *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) (“The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation’s internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands.”).

²⁷ Bebchuk & Cohen, *supra* note 1, at 396.

²⁸ Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1575 (2002).

²⁹ See discussion *infra* Part II.

³⁰ Bebchuk & Cohen, *supra* note 1, at 384; Daniel R. Fischel, *The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware’s Corporation Law*, 76 NW. U. L. REV. 913, 919–20 (1982); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 254–55 (1977).

³¹ Bebchuk & Cohen, *supra* note 1, at 384; William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 672 (1974).

³² Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553, 558 (2002) (“Among other things, we show that our account of state competition undermines the view that rules produced by state competition should be regarded as presumptively efficient.”).

A third approach provides a middle ground—that there is a race to the top for some corporate law provisions and a race to the bottom for others.³³ Highlighting the management-shareholder agency problem; explained *infra* Part III.A., the third approach argues that there is a race to the bottom only for those issues that are “significantly redistributive” between management and shareholders.³⁴ In other words, states will provide laws that favor management interests to the detriment of firm efficiency when those corporate laws significantly affect the relationship between management and shareholders.

Empirical evidence supports the third approach. Uniformity among the states with regard to most corporate law provisions suggests that states do race to the top and converge upon efficient and flexible laws where management and shareholder interests align.³⁵ Where management and shareholder interests do not align—for example, management self-dealing transactions, takeover bids and proxy contests—empirical evidence shows that non-extreme antitakeover provisions are attractive to firms³⁶ but decrease firm value.³⁷ Extreme antitakeover provisions, on the other hand, are not more attractive to firms or more successful at securing corporate charters than typical antitakeover provisions.³⁸ Instead, extreme

³³ Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1446 (1992) (citing Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 273–81 (1985); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 720–25 (1987)).

³⁴ Bebchuk, *supra* note 33, at 1441, 1461–62 (defining “significantly redistributive issues” to involve self-dealing transactions, taking of corporate opportunities; insider trading, takeover bids, proxy contests and transfers between public shareholders and controlling shareholders).

³⁵ William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715, 736 (1998) (“corporate law has a strong tendency toward uniformity, but . . . all corporate laws are not identical”).

³⁶ Bebchuk & Cohen, *supra* note 1, at 387–88 (noting in hindsight that states may have lost corporations had they not adopted antitakeover legislation).

³⁷ Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 856 n.46 (1993) (citing empirical studies following implementation of antitakeover legislation generally); Subramanian, *supra* note 1, at 1872 (“Empirical evidence from the financial economics literature suggests that anti-takeover statutes reduce shareholder value.”).

³⁸ Subramanian, *supra* note 1, at 1860 (“I find no evidence that companies migrate to the extreme statutes in the same way that they migrate to some of the typical statutes; moreover, companies in states with extreme statutes opt out from these statutes at a higher rate than companies in other states.”). *But see* Bebchuk & Cohen, *supra* note 1, at 387–88, 415 (“However, we find no evidence that the passage of these statutes has hurt the states adopting them in the incorporation market. Thus, it might be that the antitakeover protections established by

antitakeover provisions unnecessarily impose costs on firms to decrease efficiency without the concurrent benefits of attracting talented management and corporate charters to a particular state.³⁹

Following the middle ground approach in the race debate, Ohio should maintain common antitakeover provisions and repeal extreme and complex provisions to support more efficient companies and increase firm value for Ohio corporations. For example, Ohio should repeal its “anti-staple statute”⁴⁰ which requires potential acquirers to solicit shareholder proxies separate from tender offers to shareholders.⁴¹ The anti-staple statute has no practical effect to attract management with increased discretion to manage corporate affairs, but does impose an unnecessary additional cost—mailing the proxy and tender offer separately, or using two staples instead of one.⁴² In addition, local attorneys are needed to ensure that businesses comply with the anti-staple statute and other complex or unique provisions. As a result, there are unnecessary costs on value-creating business combinations in Ohio. As will be explained in Part IV, *infra*, many Ohio laws should be reformed or repealed to provide clarity and adopt this middle ground approach in the race debate.

B. The Stakeholder Debate

Underlying Ohio’s extreme antitakeover statutes is its stance in the long-standing stakeholder debate regarding the fundamental role of businesses in society.⁴³ Corporate law in Ohio and other “constituency

Pennsylvania, Ohio, and Massachusetts do not reach the level that would start discouraging incorporators.”); *id.* at 415 (“We should caution, however, against drawing from our findings any firm conclusions with respect to the effects of the adoption of extreme statutes. The dummy for recapture statute is in fact a dummy for Pennsylvania and Ohio, and the staggered board dummy is a dummy for Massachusetts, and these three states might have some special features other than having these extreme statutes.”).

³⁹ Subramanian, *supra* note 1, at 1860–61.

⁴⁰ The term “anti-staple statute” is borrowed from Professor Dale Oesterle’s class lectures.

⁴¹ OHIO REV. CODE ANN. § 1701.48(C)(2) (West 2009).

⁴² Gary P. Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 U. CIN. L. REV. 108, 120 (1983) (“Ordinarily it would be assumed that persons desiring to sell their shares would also vote for the control share acquisition. However, the tendering of the shares and the soliciting of the proxies must take place in separate transactions so that, for example, a letter of transmittal of shares being tendered could not also serve to appoint a proxy. While this may not appear to impose an obstacle, the difficulties of reaching and communicating with many thousands of shareholders will create logistical problems.”).

⁴³ See A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1365 (1932); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148–49 (1932).

states⁴⁴ provide that corporate directors owe a legal duty to act in shareholders' best interests and also all other constituencies' interests. These constituencies (or "stakeholders") include not only shareholders, but also suppliers, creditors, employees, long-term firm interests and society at large.⁴⁵ The purported policy rationale behind constituency statutes is that corporations should be held accountable to multiple constituencies because such constituencies have a vested interest in the success of the firm,⁴⁶ but in practice these laws instead protect management from shareholder accountability.⁴⁷

1. *Multiple Constituencies' Interests: Efficient Markets and Bargaining Power*

Ohio's constituency stance should be replaced with shareholder primacy principles.⁴⁸ As an initial matter, shareholder primacy principles in fact benefit all constituencies.⁴⁹ Because shareholders are residual claimants on corporate profits, they benefit only after fixed obligations to creditors, employees and government have already been paid.⁵⁰ In most situations,

⁴⁴ As of 1999, forty-one states had adopted statutes permitting directors to consider non-shareholder interests. Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROBS. 9, 28 n.134 (1999) (citing state constituency statutes).

⁴⁵ § 1701.59(F).

⁴⁶ Sarah S. Nickerson, *The Sale of Conrail: Pennsylvania's Anti-Takeover Statutes Versus Shareholder Interests*, 72 TUL. L. REV. 1369, 1406–09 (1998); see also Kent Greenfield, *Panel 1: Stakeholder Theory and the Relationships Between Host Communities and Corporations: Defending Stakeholder Governance*, 58 CASE W. RES. L. REV. 1043, 1043–44 (2008).

⁴⁷ Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 996 (1992); George W. Dent, Jr., *Stakeholder Governance: A Bad Idea Getting Worse*, 58 CASE W. RES. L. REV. 1107, 1129 (2008); Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2525 (2005) ("[Constituency statutes'] effect has largely been to give managers a rhetorical basis for opposing takeovers.").

⁴⁸ See George Dent, *The Essential Unity of Shareholders and the Myth of Short-Termism*, 35 DEL. J. CORP. L. 97, 142–48 (2010). But see Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 288–89 (1999).

⁴⁹ Dent, *supra* note 47, at 1113–14; Easterbrook & Fischel, *supra* note 18, at 1191 ("Maximization of shareholders' wealth ultimately works to the advantage of workers and suppliers, because shareholders gain only from the firm's mutually beneficial transactions with those persons.").

⁵⁰ Dent, *supra* note 48, at 100 n.6 (2010) (citing literature on shareholders as residual claimants on corporate profits); Easterbrook & Fischel, *supra* note 18, at 1190. But see LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* 38–41

shareholder interests are thus aligned with the interests of other constituencies.⁵¹

The market for corporate control disciplines management behavior in conducting corporate affairs through stock price.⁵² Inefficient management or management that does not maximize firm value for shareholders and other investors will cause a firm's stock price to fall.⁵³ When stock price falls due to mismanagement, there are reduced costs to gain control of the firm and outside investors may profit by replacing management to improve efficiency and increase stock price.⁵⁴ Management, conscious that a change in control threatens their job security, will manage corporate affairs in an efficient manner.⁵⁵ In this way, shareholder primacy in corporate law creates wealth with management accountability to shareholders.

In recent years, a debate has emerged to challenge market efficiency and its implications for shareholder primacy in the stakeholder debate.⁵⁶ As

(2012); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 IOWA J. CORP. L. 637, 658–59 (2006).

⁵¹ Dent, *supra* note 47, at 1113–14, 1122–23.

⁵² Edgar v. MITE Corp., 457 U.S. 624, 643–44 (1982) (“The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.”); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–13 (1965); *see also* Easterbrook & Fischel, *supra* note 18, at 1187 (providing data that supports the market for corporate control as a disciplining mechanism because share price of acquired firms decline steadily prior to tender offers). “The source of the premium is the reduction in agency costs, which makes the firm’s assets worth more in the hands of the acquirer than they were worth in the hands of the firm’s managers.” *Id.* at 1173; *see also* Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 IOWA J. CORP. L. 691, 696 (2003) (“stock-for-stock transactions would cancel out irrational pricing to the extent that the market as a whole is subject to a speculative bubble”).

⁵³ Easterbrook & Fischel, *supra* note 18, at 1173–74.

⁵⁴ *Id.*

⁵⁵ Dale A. Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 55–56 (1985) (stating that management does have a self interest in job security, but noting that loyal and conscientious management can provide value to dispersed shareholders); *see also* Easterbrook & Fischel, *supra* note 18, at 1175 (critically noting that management will adopt takeover defenses, not for the best interests of the firm, but to preserve their individual “salaries and status”).

⁵⁶ For further reading, see the following articles: William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010); Lawrence Cunningham, *Behavioral Finance and Investor Governance*, 59 WASH & LEE L. REV. 767 (2002); Lawrence Cunningham, *From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis*, 62 GEO. WASH. L. REV. 546, 559 (1994); Dent, *supra* note 48; Easterbrook & Fischel, *supra* note 18, at 1165–74; Ronald J. Gilson & Reinier H.

the argument goes, if markets are inefficient, then management should not manage the firm towards maximizing shareholder value because managing towards market anomalies will not promote efficient resource allocation.⁵⁷ While a full-blown discussion on market efficiency is beyond the scope of this article, even shareholder primacy critics agree that extreme Ohio corporate law harms shareholders (i.e. investors).⁵⁸ Moreover, in light of the business judgment rule, the legal reform advocated here promotes judicially enforceable management fiduciary duties *limited* primarily to the takeover context.⁵⁹ To the extent that the debate surrounding market efficiency leads to actual objections with the reform proposed herein, the author invites future discussion on the topic.

Notwithstanding this debate, U.S. equity markets are widely considered informationally efficient such that arbitrage opportunities make the market for corporate control an effective disciplining device.⁶⁰ In fact, the disclosure-based model for U.S. securities regulation is based upon the efficient capital markets hypothesis.⁶¹ Many courts, including the U.S.

Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Ronald J. Gilson & Reinier Kraakman, *Revisiting the Mechanisms of Market Efficiency*, 28 IOWA J. CORP. L. 715 (2003); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 14 (1991); Lynn A. Stout, *Corporate Finance: How Efficient Markets Undervalue Stocks: CAPM and ECMH Under Conditions of Uncertainty and Disagreement*, 19 CARDOZO L. REV. 475 (1997); and Lynn Stout, *The Mechanisms of Market Efficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635 (2003).

⁵⁷ Michael Wachter, *Takeover Defense When Financial Markets Are (Only) Relatively Efficient*, 151 U. PA. L. REV. 787, 819–23 (2003).

⁵⁸ Fisch, *supra* note 50, at 656–57 (“Commentators widely agree that these statutes harm shareholders by (1) reducing the ability of the takeover market to discipline management decision-making and (2) making a takeover, with its likely premium for shareholders, less probable.”).

⁵⁹ The main context in which the Ohio constituency statute should be reconsidered in favor of shareholder primacy principles (i.e. to maximize shareholder value) is in takeover situations in which there is an imminent change in the control and multiple bidders (i.e. the *Revlon* Zone). See discussion *infra* Part IV.A.2. Generally, both shareholder primacy critics and proponents agree that there should an enforceable duty of loyalty in certain situations. See STOUT, *supra* note 50, at 81 (“corporate law’s duty of loyalty has real teeth, and severely limits directors’ discretion to use their corporate powers to enrich themselves”).

⁶⁰ See Dent *supra* note 48, at 116–17 (noting that investment in research and development, for example, is positively correlated with stock price); Easterbrook & Fischel *supra* note 18, at 1165–66 (discussing the market for corporate control); *id.* at 1184 (stating that stock prices reflect long-term consequences).

⁶¹ Michael W. Prozan & Michael T. Fatale, *Revisiting “Truth in Securities”: The Use of the Efficient Capital Market Hypothesis*, 20 HOFSTRA L. REV. 687, 697 (1992); see *id.* at 693–704 (discussing the origins of disclosure-based U.S. securities regulation).

Supreme Court, subscribe to the efficient capital markets hypothesis (i.e. informational efficiency).⁶²

To be clear, the most widely accepted efficient capital markets hypothesis is not that markets are perfectly efficient, but rather the “semi-strong” theory.⁶³ There may be situations in which stock price does not reflect all information, both public and private, then-existing⁶⁴: for example, stock price may not accurately reflect firm value when target managers negotiating changes in corporate control have confidential information about the firm that is not publicly available.⁶⁵ As applied to corporate law, director fiduciary responsibility should be crafted to take into account the semi-strong efficient markets hypothesis, as will be discussed *infra* Part IV.A.2.

Second, constituency statutes are unnecessary because non-shareholder constituencies may represent their interests by contract.⁶⁶ Critics argue that shareholders and management harm absent third parties when negotiating corporate governance rules.⁶⁷ So the argument goes, it is impracticable for these constituencies to expressly contract to represent their numerous interests.⁶⁸ The result is implicit agreements with management that are effectively subordinate to express shareholder agreements.⁶⁹ However, collective bargaining agreements or employment contracts,⁷⁰ bond

⁶² *E.g.*, *Basic, Inc. v. Levinson*, 485 U.S. 244, 246 (1988) (“Recent empirical studies have tended to confirm Congress’ premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations.”); *Levinson v. Basic, Inc.*, 786 F.2d 741, 750 (6th Cir. 1986); *In re LTV Securities Litig.*, 88 F.R.D. 134, 144 (N.D. Tex. 1980) (“the prices of stocks of larger corporations, such as those listed on the New York Stock Exchange, seem especially efficient”).

⁶³ Fama, *supra* note 9, at 409; Gilson & Kraakman, *supra* note 56, at 551; Dale Arthur Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 125 (1986); *see also* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1432 (1989) (noting that stock price does not reflect non-public information).

⁶⁴ Oesterle, *supra* note 63, at 125–26.

⁶⁵ *Id.* at 126.

⁶⁶ Dent, *supra* note 47, at 1115.

⁶⁷ *E.g.*, *Do Poison Pills Make You Strong?*, ECONOMIST (U.S.), June 29, 1991, at 59; *see* Easterbrook & Fischel, *supra* note 63, at 1429–30, 1436–41.

⁶⁸ *Do Poison Pills Make You Strong?*, *supra* note 67.

⁶⁹ *Id.*

⁷⁰ *But see* *Air Line Pilots Ass’n Int’l v. UAL Corp.*, 897 F.2d 1394, 1399–400 (7th Cir. 1990) (invalidating an antitakeover device in an employment contract with a labor union).

indentures⁷¹ and government contracts are some instances, among others, in which employees, creditors and society may bargain to represent their interests in corporate governance. Direct regulation in situations where there is truly unequal bargaining power, as well as exit options for constituent interests, are more appropriate remedies for aggrieved third parties than open-ended corporate law.⁷²

Thus, unequal bargaining power does not adequately explain shareholder prominence in corporate governance.⁷³ A more plausible explanation is that shareholders are the constituency willing to pay the highest premium for corporate control, which also explains why corporate law reform is material to business formation.⁷⁴ Namely, shareholder wealth declines in constituency jurisdictions and raises the cost of capital, thereby deterring investment.⁷⁵ In sum, constituency statutes that are broadly applicable to all areas of corporate law are not fit to protect the constituency groups they purport to protect.

2. Management Protection

More bluntly, constituency statutes are an artifice that caters to management interests with protection from shareholder accountability.⁷⁶ That is, constituency provisions are designed not to benefit non-shareholder constituencies, but instead to give management nearly unbridled discretion in managing corporate affairs.⁷⁷ Because a duty to all is effectively a duty to none, it is not clear how a constituency other than shareholders could ever enforce a corporate director's legal duty.⁷⁸ In effect, then, constituency

⁷¹ See, e.g., *Metro. Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504, 1517 (S.D.N.Y. 1989) (absolving directors from liability to bondholders absent express covenants in the bond indenture).

⁷² Dent, *supra* note 47, at 1126–28 (arguing that direct regulation is more appropriate than imposing corporate fiduciary duties in situations where there is truly unequal bargaining power); *id.* at 1136 (identifying exit options in negotiations situations).

⁷³ See *id.* at 1134–37.

⁷⁴ See *id.* at 1120–21.

⁷⁵ Subramanian, *supra* note 1, at 1830; see also Dent, *supra* note 47, at 1121; Romano, *supra* note 37, at 856 n.46.

⁷⁶ Bainbridge, *supra* note 47, at 996; Dent, *supra* note 47, at 1129. But see Porter, *supra* note 23, at 639–40, 679–81.

⁷⁷ See Kent Greenfield & D. Gordon Smith, *Debate: Saving the World with Corporate Law?*, 57 EMORY L.J. 948, 966–67 (2008).

⁷⁸ Easterbrook & Fischel, *supra* note 18, at 1190–92 (“A manager responsible to two conflicting interests is in fact answerable to neither.”); see also Roe, *supra* note 47, at 2525–26 (citing a failed legislative proposal in CA to provide non-shareholder constituencies with a cause of action against corporate directors); Ryan J. York, Comment, *Visages Of Janus: The Heavy Burden of Other Constituency Anti-Takeover Statutes on Shareholders and the Efficient Market for Corporate*

statutes severely limit the potency with which corporate law holds management accountable for poor performance or misconduct.

Still, shareholder primacy critics argue that management discretion encourages management to enter into value-creating deals and also to attract talented management with the prospect of limiting shareholder derivative litigation.⁷⁹ Eliminating fiduciary duties, however, is not in the best interest of the corporation for several reasons: excessive director discretion decreases shareholder wealth and raises the cost of capital; reincorporation in Ohio is deterred because it signals to the market that management is inefficient; and relaxed duties invite director misconduct.⁸⁰

Moreover, alternatives to eliminating fiduciary duties under constituency statutes are available if these provisions are desirable to some firms. Ordinary rather than extreme legislation similarly attracts management to adopt state corporate law. Also, rather than effectively eliminating fiduciary duties, laws may be written to enable corporations to amend fiduciary duties if desired.⁸¹

As will be explained in detail, *infra* Part IV.A, Ohio's constituency stance in the stakeholder debate reflects a race to the bottom which should be abandoned in favor of shareholder primacy principles. As the leader in corporate law, Delaware has had great success attracting efficient firms with corporate law that reflects shareholder primacy principles.⁸² Further, the constituency view raises the cost of capital to Ohio firms,⁸³ reduces efficiency and excessively caters to management interests by limiting their accountability to shareholders.

Control, 38 WILLAMETTE L. REV. 187, 195–96 (2002) (citing and summarizing *Abrahamson v. Waddell*, 624 N.E.2d 1118 (Ohio Misc. 2d 1992)). Moreover, if a jurisdiction gave a non-shareholder constituency a seat on the board of directors, which no U.S. state requires, it is not clear how we would assign board seats among all constituencies. Dent, *supra* note 47, at 1118.

⁷⁹ See Romano, *supra* note 37, at 847–50; see also Ryngaert & Netter, *supra* note 19, at 376.

⁸⁰ See discussion *infra* Part IV.A; see also Romano, *supra* note 37, at 850–51.

⁸¹ See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2010); see also Angus Loten, *With New Law, Profits Take a Back Seat*, WALL ST. J., Jan. 19, 2012, http://online.wsj.com/article/SB10001424052970203735304577168591470161630.html?mod=WSJ_business_LeftSecondHighlights.

⁸² In Delaware, directors are required to act in the best interests of shareholders rather than to benefit divergent constituency interests. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 185 (Del. 1986). Professor Stout argues that shareholder primacy principles in Delaware are limited to the takeover context, but recent Delaware cases have refuted this position. See Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 169–72 (2008).

⁸³ See Ryngaert & Netter, *supra* note 19, at 376.

Abercrombie's recent experience attempting to reincorporate is particularly insightful in this regard because it shows that Ohio's extreme stance of catering to management interests at shareholder expense does not make Ohio an attractive reincorporation choice.⁸⁴ Moreover, the Abercrombie experience suggests that market prices do take corporate law provisions into account because shareholders took Ohio corporate law into account when voting on reincorporation.⁸⁵ In sum, to adopt positions in the race and stakeholder debates that benefit Ohio businesses, Ohio should reform its corporate law to be less complex and extreme. Whereas the present section provides a foundation in theory, Part III next turns to practical reasons for reforming Ohio corporate law.

III. REFORMING OHIO CORPORATE LAW: PRACTICAL CONSIDERATIONS

Ohio should engage in limited competition with Delaware to incorporate in-state firms under Ohio law. To be clear, Ohio does not need to engage in competition with Delaware to be the leader in corporate law in order to materially benefit from reform. The primary benefit to making Ohio an attractive incorporation choice is not tax related, but rather lowering the cost of capital to in-state firms and encouraging investment in Ohio.⁸⁶ Moreover, simply providing statutory clarity and flexibility to change statutory default rules can limit agency costs and the inefficiency associated with mandatory rules (i.e. higher cost of capital).⁸⁷ With these modest objectives, Ohio should focus on limited competition with Delaware to incorporate Ohio-based firms in Ohio. This section will explain (1) political problems with Ohio corporate law reform; (2) how reform will benefit Ohio businesses and government; and (3) why Ohio should engage in limited reform targeting local investment and firms located in Ohio.

⁸⁴ ISS PROXY ADVISORY SERVS., *supra* note 14, at 4–6; *see also Abercrombie Not Yet Ready to Be an Ohio Player*, *supra* note 15.

⁸⁵ ISS PROXY ADVISORY SERVS., *supra* note 14, at 4–6; *see also supra* note 9 and accompanying text.

⁸⁶ *See Dent*, *supra* note 47, at 1129; Ryngaert & Netter, *supra* note 19, at 376.

⁸⁷ Winter, *supra* note 30, at 259 (“But substituting a mandatory legal rule for bargaining also may impose a cost in the form of the elimination of alternatives which the parties might prefer.”); *see Kobayashi & Ribstein*, *supra* note 18, at 1174 (discussing agency costs and noting that “[i]n short, the efficiency of state corporate law depends on its marginal costs and benefits in controlling agent cheating given other constraints on agency costs”); Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 390–91 (2003) (“Contractual choice of law provides exit from state laws that would otherwise impose costs on the parties. This avoidance function of choice-of-law clauses matters most regarding mandatory rules that cannot cheaply be avoided by simply drafting alternative contract provisions.”).

A. Private Incentives and Ohio Corporate Law Politics

Management and attorneys are the two major interest groups that may make it difficult to strike an appropriate balance between management and shareholder interests when drafting corporate law.⁸⁸ These special interests are particularly important because they heavily influence firm incorporation decisions and may have interests that diverge from shareholder interests.⁸⁹ Moreover, these interests lead to litigation costs regarding agency issues and other professional services costs that are associated with inefficient corporate law.⁹⁰

First, management interests may be an obstacle to efficient corporate law if mandatory rules limit firm flexibility to choose charter provisions and bylaws. Corporate law is designed to address agency problems that exist among shareholders and management when their interests do not align.⁹¹ Traditionally, shareholders and other investors (e.g., creditors) passively provide capital to represent their interests.⁹² In addition to a passive role in corporate governance, shareholders often do not vote in the applicable jurisdiction or otherwise directly voice their interests in the legislative process.⁹³

By contrast, management plays a more active role in corporate governance, and may pursue self-interests, including job security and

⁸⁸ Carney, *supra* note 35, at 717–18; Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 705–06 (2002).

⁸⁹ Daines, *supra* note 28, at 1586 (“Romano found that reincorporation decisions were typically motivated by lawyers rather than managers.” (citing Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 274 (1985))); Bebchuk & Cohen, *supra* note 1 (noting management influence on incorporation decisions); Easterbrook & Fischel, *supra* note 63, at 1420.

⁹⁰ Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 504–05 (1987) (noting the litigation fees and advisory expenses associated with corporate governance).

⁹¹ Easterbrook & Fischel, *supra* note 18, at 1170; Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–11 (1976); *see also* Romano, *supra* note 37, at 843 (stating that there is an agency problem among management and shareholders when their interests do not align).

⁹² Easterbrook & Fischel, *supra* note 18, at 1171; *see also* John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 654 (1999) (“shareholders seem the classic example of Mancur Olson’s ‘inchoate group,’ namely, a group that, although large in number, is not well organized and hence has less ability to influence political decisions than smaller but better organized groups such as labor or corporate managers” (emphasis added)).

⁹³ *See* Coffee, *supra* note 92, at 656.

limited personal liability, that do not align with investor interests.⁹⁴ In the political sphere, management may lobby legislatures to directly affect the political process, especially if their attorneys are involved in the legislative drafting process.⁹⁵ In their more active role, manager interests may drown out diffuse shareholders' interests and voice in corporate governance absent a neutral legal environment.⁹⁶

Because corporate law is designed in large part to remedy this agency problem, corporate law is most important where shareholder and management interests diverge, which will be the subject of the statutory analysis *infra* Part IV.A. These provisions should provide neutral default rules that take both management and shareholder interests into account, are clear in application, and are discretionary such that firms may contract around them.⁹⁷ If discretionary default rules provide management with alternatives to pursue their interests outside the legislative process, the threat that management poses to efficient and flexible corporate law is diminished.⁹⁸ With discretionary default rules, management may seek to change corporate charters and bylaws away from statutory default rules rather than affect the legislative process.⁹⁹

To be sure, Ohio corporate law excessively supports management interests to the detriment of shareholder interests and the overall business environment.¹⁰⁰ Some fiduciary duty provisions, for example, are

⁹⁴ Carney, *supra* note 35, at 750–51 tbl.3. For example, management sponsored antitakeover legislation in the 1980's. *Id.* In Ohio, for example, Goodyear Tire was a major corporate proponent of antitakeover legislation. *Id.*

⁹⁵ *Id.* at 750.

⁹⁶ Easterbrook & Fischel, *supra* note 18, at 1171 (discussing the shareholder collective action problem); *see, e.g.*, Bebchuk & Hamdani, *supra* note 32, at 592–93; Davidoff, *supra* note 4 (noting that Abercrombie's recent attempt to reincorporate in Ohio may have furthered management interests which are not necessarily in line with shareholder interests); *see also* Coffee, *supra* note 92, at 647 (stating that one theory posits "that shareholder dispersion depends on the ability of the legal system to protect minority shareholders").

⁹⁷ Kahan & Kamar, *supra* note 88, at 739–41 (noting that corporate law that avoids litigation and strikes a real balance between management and shareholders is attractive to firms); Winter, *supra* note 30, at 259 (noting that mandatory rules may impose costs on firms).

⁹⁸ *See* Carney, *supra* note 35, at 728 ("[M]anagement's interest in general matters of state corporate law will be less intense than that of the bar."); *see, e.g.*, Macey & Miller, *supra* note 90, at 521–22 (noting that poison pills can serve management interests outside the legislative process).

⁹⁹ Carney, *supra* note 35, at 728. Another alternative to management lobbying the legislature to achieve its interests is incorporation in another jurisdiction.

¹⁰⁰ *See* discussion *infra* Part IV; *see, e.g.*, Davidoff, *supra* note 4 (noting potentially misaligned interests between Abercrombie's management and shareholders under Ohio corporate law).

effectively non-existent and Ohio's six antitakeover statutes, taken together, are extreme.¹⁰¹ Further, some discretionary provisions do not have neutral default rules.¹⁰² As a result, Ohio managers have significant discretion to advance their interests and reduce competitive pressure to run an efficient company.

Second, local attorneys have incentives not to advocate efficient and flexible laws that increase and retain incorporations.¹⁰³ While local attorneys benefit from increasing local incorporations because of a larger legal market, they do not benefit if attorneys from other jurisdictions are also attracted to the larger market.¹⁰⁴ As a result, they may advocate complex legal rules that differ with competing jurisdictions—like Delaware—as a barrier to entry for out-of-state attorneys.¹⁰⁵ Similarly, local attorneys may not be interested in legal rules that increase incorporations in the long run because new attorneys may enter the market during that time.¹⁰⁶ In addition, a free-rider problem may discourage local attorneys from investing time in drafting legislation to increase incorporations and the size of the market for legal services.¹⁰⁷ That is, other attorneys will benefit from the considerable time and effort that is required to draft and consistently update corporate law.

Indeed, Ohio legislators depend on the Ohio State Bar Association for input into the legislative drafting process,¹⁰⁸ and difficult to understand Ohio law likely places a premium on local attorneys' services. The Delaware Bar has similarly been identified as an interest group that may

¹⁰¹ See discussion *infra* Part IV.A.3.

¹⁰² E.g., OHIO REV. CODE ANN. § 1701.59(E) (West Supp. 2012) (firms must opt out of the heightened business judgment rule for damages); see discussion *infra* Part IV.A.2.

¹⁰³ Carney, *supra* note 35, at 717–18, 720–21.

¹⁰⁴ See Kahan & Kamar, *supra* note 88, at 605–06.

¹⁰⁵ See *id.*

¹⁰⁶ *Id.* at 705.

¹⁰⁷ *Id.* at 706.

¹⁰⁸ One practitioner of Ohio corporate law has commented on the Ohio legislative process for corporate law:

A simple amendment to section 1701.55 was processed in the ordinary course through the Ohio State Bar Association machinery and a sponsor found in the Legislature. As far as I know, there was no opposition to this amendment when it was introduced as House Bill 134 and enacted in 2007 While I disagree with that viewpoint, as the Corporation Law Committee's comments actually reflected the consensus view of the leading Ohio corporate law experts about Ohio law at that time, it hardly matters. The law today is what the statute says it is.

Porter, *supra* note 23, at 664–65 (emphasis added).

advocate complex statutes and legal rules that increase demand and fees for local attorneys.¹⁰⁹ Therefore, it may be necessary to include additional parties in drafting Ohio corporate law. In light of its extreme and complex nature, and the special interests identified here, Ohio corporate law is consistent with private interests affecting the law.

B. *State Competition for Corporate Charters Matters*

Ohio should compete for corporate charters with laws that are attractive to both managers and shareholders. Among other firm benefits, corporate law reform in Ohio will increase firm efficiency and lower the cost of capital to firms incorporating under Ohio law.¹¹⁰ In addition, reform will provide collective benefits to Ohioans and Ohio government.

Notwithstanding these benefits, the case for reforming Ohio corporate law should not be overstated: making Ohio an attractive incorporation choice is more likely to attract a firm's corporate headquarters than manufacturing centers, customer service centers, warehouses and retail locations. Even firms incorporated under Ohio laws could locate their headquarters outside Ohio. To demonstrate that incorporation in a particular jurisdiction is distinct from other decision-making, consider that Eaton Corp., formerly an Ohio company, recently reincorporated in Ireland for tax reasons, but plans to keep factories, offices and other operations in the United States.¹¹¹

1. *Lowering the Cost of Capital to Ohio Businesses*

Corporate laws that recognize investor interests are needed to lower the cost of capital to Ohio firms. Because investors provide capital, legal reforms to promote management accountability to shareholders will remedy agency problems between management and shareholders under extreme

¹⁰⁹ Macey & Miller, *supra* note 90, at 503–05 (“Delaware could stimulate litigation by supplying legal rules that are unclear in application. The bar therefore has some interest in reducing the clarity of Delaware law to enhance the amount of litigation.”).

¹¹⁰ Professor John Coffee argues that law matters because a jurisdiction's legal system must protect public or minority investors before liquid securities markets will effectively monitor management with share prices that indicate either firm efficiency or mismanagement. See Coffee, *supra* note 92, at 644–47 (“The most convincing explanation [for the correlation between liquid equity markets in the United States and United Kingdom, but not other countries] . . . is that only those legal systems that provide significant protections for minority shareholders can develop active equity markets.”).

¹¹¹ John D. McKinnon & Scott Thurm, *U.S. Firms Move Abroad to Cut Taxes*, WALL ST. J., Aug. 28, 2012, <http://online.wsj.com/article/SB10000872396390444230504577615232602107536.html>.

Ohio corporate law.¹¹² Taking shareholder interests into account will attract capital because investors will require a smaller premium to compensate them for limited representation in corporate governance.¹¹³ In turn, businesses benefit from and are attracted to an environment where it is less expensive to raise capital.¹¹⁴ Put differently, access to capital is an incentive to conduct business in Ohio that is poorly implemented under Ohio corporate law and thus warrants thoughtful discussion.

Empirical data show that it is unnecessarily expensive for businesses to raise capital under Ohio law. Following the enactment of Ohio antitakeover legislation in 1986, event studies found a 2% decrease in the stock value of Ohio corporations.¹¹⁵ Additional empirical evidence shows decreases in shareholder wealth following enactment of antitakeover legislation in other states.¹¹⁶ Lower stock prices reflect that Ohio law reduces the takeover premium inherent in stock value.¹¹⁷ Specifically, as management has considerably more discretion under Ohio law than under comparative law, there is less risk of a corporate takeover that would otherwise enhance stock value due to efficiency gains and the premium paid to shareholders during acquisitions.¹¹⁸ Significantly, lower market stock price and market capitalization for Ohio companies represents a higher cost of raising capital and generating business activity. The higher cost of capital referenced here

¹¹² See Easterbrook & Fishel, *supra* note 18, at 1170–73; Kobayashi & Ribstein, *supra* note 18, at 1174.

¹¹³ Coffee, *supra* note 92, at 698 (“In addition, legal rules in both the United States and the United Kingdom protect the dispersed shareholder from the ‘creeping’ acquisition of control without the payment of a *control premium*.” (emphasis added)); see also Dent, *supra* note 47, at 1121.

¹¹⁴ Easterbrook & Fishel, *supra* note 18, at 1173; Kobayashi & Ribstein, *supra* note 18, at 1167, 1172–74 (“In other words, managers must pay investors for permission to cheat them.”).

¹¹⁵ Ryngaert & Netter, *supra* note 19, at 374; Ryngaert & Netter, *Revisited*, *supra* note 19, at 253 (supporting methodology used for their 1986 article); Oesterle, *supra* note 19, at 911–13 (supporting methodology). But see Margotta, McWilliams & McWilliams, *supra* note 19, at 235 (1990) (critically analyzing the methodology used in the 1986 Ryngaert and Netter article).

¹¹⁶ Bebchuk & Cohen, *supra* note 1, at 387 (stating in hindsight that states may have lost corporations had they not adopted antitakeover legislation); Romano, *supra* note 37, at 856 n.46 (citing empirical studies following implementation of antitakeover legislation generally).

¹¹⁷ Romano, *supra* note 37, at 843 n.46 (citing studies); Subramanian, *supra* note 1, at 1827–30 (stating that empirical studies show stock value decreases following the adoption of antitakeover statutes and that virtually all academic commentators agree that antitakeover statutes decrease shareholder value).

¹¹⁸ Subramanian, *supra* note 1, at 1827–30.

includes lower-valued equity and higher borrowing costs (e.g., higher interest rates) incurred in debt markets.¹¹⁹

Aside from the higher cost of capital, Ohio corporate law inflicts other unnecessary expenses upon Ohio businesses as well. First, Ohio's complex and unique corporate law essentially requires Ohio corporations to hire lawyers with expertise in Ohio law. Exacerbating the legal cost is the likelihood that businesses may want to opt out of unconventional Ohio default rules, such as the shareholder voting provisions.¹²⁰ By contrast, more typical corporate law subjects local lawyers to competition with corporate lawyers in other jurisdictions and potentially drives down legal expenses.¹²¹ Second, and related to the corporate law context, excessive state securities regulation causes Ohio businesses to incur unnecessary expenses, including transaction costs, when raising capital.¹²² Because of these expenses, Ohio should reform corporate law and securities regulation to lower the cost of doing business in-state.¹²³

In the alternative, if Ohio corporations opt out of Ohio law with incorporation in Delaware, still other costs are inflicted upon businesses located in Ohio.¹²⁴ First, Ohio-based corporations incorporated in Delaware are effectively taxed twice.¹²⁵ That is, such corporations are burdened with Ohio's gross receipts tax (the Commercial Activities Tax) in addition to

¹¹⁹ Conversely, if a firm's capital structure is adjusted to provide for more or less equity relative to debt, the cost of equity capital is inversely related to the cost of debt capital. Fisher Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637, 650 (1973).

¹²⁰ See discussion *infra* Part IV.A.

¹²¹ Carney, *supra* note 35, at 721 (stating that lawyers may make litigation more costly "by creating some amount of market power over advising and litigating under a set of corporate laws").

¹²² Cf. Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789, 857 (2002) ("Complicated legal environments in which multiple jurisdictions or vertically related authorities regulate the same subject raise like transitional concerns. When, for example, a field is subject to comprehensive state, national, and international regulation (in, say, intellectual property law), large-scale reform at any level without careful accommodation is likely to risk severe legal transition costs.").

¹²³ See discussion *infra* Part IV.A (corporations); Part IV.B (LLCs); Part IV.C (securities regulation).

¹²⁴ Several statistics indicate that Delaware is Ohio's main competitor for corporate law. First, 97% of all companies incorporate in either their home state or Delaware. Daines, *supra* note 28, at 1562. Second, 95% of all companies that do not incorporate in their home state incorporate in Delaware. *Id.* at 1563. Third, nearly 70% of all companies going public incorporate in Delaware. *Id.*

¹²⁵ See Bebhuk & Hamdani, *supra* note 32, at 573 (Delaware franchise tax).

Delaware franchise taxes.¹²⁶ By contrast, a manufacturing corporation incorporated in Ohio is subject to Ohio's Commercial Activities Tax, but avoids Delaware's franchise tax.¹²⁷ This result cuts against Ohio's tax policy to attract manufacturing businesses by replacing its corporate franchise tax and personal property tax with a gross receipts tax limited to in-state revenue.¹²⁸

Second, Ohio based companies incorporated in Delaware are subject to litigation in Delaware.¹²⁹ The prospect of traveling to Delaware for legal defense and hiring local legal counsel is a potentially large cost that could make opting out of Ohio law prohibitively expensive.¹³⁰ To avoid forcing businesses to incur the costs of either Ohio incorporation or out-of-state incorporation, Ohio should revise Ohio corporate law to make Ohio incorporation a neutral and attractive choice.

2. Governmental Advantages

Corporate law affects a firm's incorporation choice and consequently benefits states that adopt attractive corporate law.¹³¹ Delaware has established itself as the dominant leader in incorporation choice because it offers (1) a specialized Chancery Court¹³² with expedited proceedings and no jury trials; (2) case law that provides *certainty*¹³³ and is understood

¹²⁶ DEL. DIV. OF CORPS., 2009 DELAWARE ANNUAL REPORT 1 (noting Division of Corporations revenue from business entity taxes and other fees).

¹²⁷ *Corporation Franchise Tax*, OHIO DEP'T OF TAXATION, 2010, at 42. Notably, Abercrombie's proposed reincorporation in Ohio would have saved the company \$180,000 in tax liability. ISS PROXY ADVISORY SERVS., *supra* note 14, at 4–6; Davidoff, *supra* note 4.

¹²⁸ April Butler, *Comment: A Look at What the Cat Dragged in: The Problems Inherent in Ohio's Commercial Activity Tax*, 32 U. DAYTON L. REV. 99, 107 (2006).

¹²⁹ See Bebhuk & Hamdani, *supra* note 32, at 573.

¹³⁰ See Macey & Miller, *supra* note 90, at 504–05 (noting that the Delaware corporate bar is likely to favor laws that increase demand for local legal services).

¹³¹ Bebhuk & Cohen, *supra* note 1, at 383; see Subramanian, *supra* note 1, at 1795.

¹³² Lewis S. Black, Jr., *Why Corporations Choose Delaware*, DELAWARE.GOV (Del. Dep't of State Div. of Corps.), 2007, at 5–7.

¹³³ One Ohio practitioner has argued that Ohio corporate law is more certain than Delaware law. Feran, *supra* note 10 (“But the fact is, Ohio law isn’t drastically different from Delaware law—except for the fact that it’s certain.” (quoting John Beavers)). However, Former Chief Justice of the U.S. Supreme Court William Rehnquist spoke very highly of the certainty provided by the Delaware Chancery Courts:

[S]ince the turn of the century, it has handed down thousands of opinions interpreting virtually every provision of Delaware’s corporate law statute. No other state court can make such a claim

throughout the business community as predicable for business planning;¹³⁴ (3) expert judges to apply that law in litigation and optional mediation;¹³⁵ (4) an engaged corporate law bar that is heavily relied upon for annual review of the Delaware General Corporate Law and has agreed to leave its self-interests behind;¹³⁶ and (5) quality service from the Delaware Secretary of State's Office.¹³⁷ While competition with Delaware as the leader in state corporate law is a questionable goal,¹³⁸ limited and inexpensive Ohio reform is a practical goal that will benefit the local economy and preserve some governmental revenue Delaware currently imports from Ohio.

i. *State Incorporation Rates and Revenue Data*

As the leading provider of corporate law, Delaware incorporated 63% of all Fortune 500 companies and 879,000 business entities in total in 2009.¹³⁹ Generally, Delaware accounts for more than half of all U.S. corporations.¹⁴⁰ As a result, Delaware enjoys substantial financial benefits including tax revenue, filing fees and property that escheats to the state.¹⁴¹ In 2011, Delaware amassed \$614 million in franchise fees and taxes, \$83 million in filing fees and \$428 million in escheated property,¹⁴² which totaled about 32% of its general revenue fund.¹⁴³

... Perhaps most importantly, practitioners recognize that "[o]utside the takeover process . . . most Delaware corporations do not find themselves in litigation. The process of decision in the litigated cases has so refined the law, that business planners may usually order their affairs to avoid law suits."

Black, *supra* note 132, at 6.

¹³⁴ Black, *supra* note 132, at 8.

¹³⁵ *Id.*; Chancellor William Chandler, Del. Chancery Court, Schottenstein Zox and Dunn Distinguished Practitioners in Residency Program: Fiduciary Responsibilities Course at the Moritz College of Law (Mar. 18–20, 2011). Chancellor Chandler also noted in class that Delaware judges are available to provide mediation services to Delaware corporations.

¹³⁶ Black, *supra* note 132, at 4–5.

¹³⁷ *Id.* at 9.

¹³⁸ See Bebchuk & Hamdani, *supra* note 32, at 612 (citing a potential federal charter as the biggest threat to Delaware's dominance). See generally Mark J. Roe, *Delaware's Shrinking Half-Life*, 62 STAN. L. REV. 125, 146 (2009).

¹³⁹ DEL. DIV. OF CORPS., *supra* note 126, at 1.

¹⁴⁰ Bebchuk & Cohen, *supra* note 1, at 389.

¹⁴¹ See DEL. DIV. OF CORPS., *supra* note 126, at 2 (providing data regarding revenue from taxes and other fees).

¹⁴² DEL. DEP'T FIN., DELAWARE FISCAL NOTEBOOK 29 (2011).

¹⁴³ See *id.*

Ohio, on the other hand, incorporates 1–2% of U.S. corporations, representing 54% of Ohio-based companies,¹⁴⁴ and increasing the volume of businesses incorporated in Ohio stands to benefit the State. Ohio's comparatively high incorporation rate among Ohio-based companies, however, should not be attributed to its pro-management provisions because Ohio's incorporation rate fell slightly following the pro-management 1986 amendments.¹⁴⁵ Because there is a home state advantage to incorporation choice,¹⁴⁶ the high incorporation rate may reflect Ohio's rich business history rather than desirable corporate law. In light of a more recent decline, a high incorporation rate does not affect Ohio's difficulties in attracting, retaining and growing businesses.¹⁴⁷ In this regard, Abercrombie's failed attempt to reincorporate in Ohio is particularly important because it provides evidence that Ohio corporate law can have a detrimental impact on a business with close ties to Ohio,¹⁴⁸ even in the presence of tax benefits under Ohio law.¹⁴⁹ A more advantageous corporate law framework will work in conjunction with Ohio's resources to facilitate in-state investment.

It is difficult to quantify the governmental benefits of businesses incorporating in Ohio, rather than Delaware, because of differing tax structures in each state. Both states impose privilege-of-doing-business taxes and filing fees, but the scope of these taxes differs greatly in each

¹⁴⁴ Lucian Bebchuk, Alma Cohen & Alan Ferrell, *Does the Evidence Support State Competition in Corporate Law?* 90 CALIF. L. REV. 1775, 1812 (2002).

¹⁴⁵ See Daines, *supra* note 28, at 1607; see also Subramanian, *supra* note 1, at 1860–61. While the evidence presented here is generally consistent with a race to the bottom, I also present evidence suggesting some limits on this view. Managers migrate to states with typical antitakeover statutes, but not to the three states with severe antitakeover statutes—Massachusetts, Ohio and Pennsylvania. *Id.*

¹⁴⁶ See Daines, *supra* note 28, at 1562 (“home-state bias”).

¹⁴⁷ For example, according to the U.S. Bureau of Labor Statistics data as of this writing, in December 2010, 300,000 fewer Ohioans were employed than in December 2000. U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, <http://data.bls.gov/timeseries/LASST39000003> (select “From: 2000” and “To: 2010” in “Change Output Options”); see also Tom Feran, *Gov. John Kasich Says Only California and Michigan Lost More Jobs Than Ohio in the Last Decade*, PLAIN DEALER POLITIFACT OHIO (Mar. 4, 2011, 6:00 AM), <http://www.politifact.com/ohio/statements/2011/mar/04/john-kasich/gov-john-kasich-says-only-california-and-michigan/>.

¹⁴⁸ “In 1996, The Limited spun off Abercrombie, which has about 600 stores and 22,000 employees.” Steven Greenhouse, *Clothing Chain Accused of Discrimination*, N.Y. TIMES, June 17, 2003, <http://www.nytimes.com/2003/06/17/national/17STOR.html>.

¹⁴⁹ Abercrombie stood to save \$180,000 per year under Ohio law. ISS PROXY ADVISORY SERVS., *supra* note 14, at 4–6; Davidoff, *supra* note 4.

state.¹⁵⁰ For example, in Ohio there is a heavier dependence on the Commercial Activity Tax, which does not depend on a firm's place of incorporation, than other taxes.¹⁵¹ Notwithstanding this difficulty, increased Ohio incorporation unquestionably provides at least some governmental revenue from escheated property and filing fees.¹⁵² Moreover, promoting Ohio incorporation is beneficial to promote small business development and strengthen existing businesses' ties to Ohio.¹⁵³ Accordingly, Ohio should undertake legal reform in this area to promote state interests.

ii. *Ohio's Interest in Propelling the Local Economy*

Providing Ohio-based companies with an attractive option to incorporate in-state, rather than in Delaware, may propel business growth with lower investment costs. If Ohio positions itself as an attractive option for incorporation, businesses may avoid both the current costs associated with Ohio law and the costs of incorporating in Delaware. The government may promote its interest in propelling the local economy with a friendly business climate that attracts investment capital.

C. *Ohio Should Engage in Limited Competition for Corporate Charters*

Ohio should engage in limited competition to encourage firms located in Ohio to incorporate in Ohio. Again, firms incorporated in Ohio will materially benefit from Ohio reform with a lower cost of capital reflecting reduced agency costs,¹⁵⁴ even if direct government benefits (e.g., tax revenue and property escheating to the state) are uncertain and firms incorporated in Ohio may locate facilities outside Ohio. In fact, merely providing statutory clarity and discretionary default rules that provide flexibility may limit agency costs and professional services costs.¹⁵⁵ And in

¹⁵⁰ Kail M. Padgitt, *2011 State Business Tax Climate Index*, BACKGROUND PAPER (Tax Found. Wash. D.C.), Oct. 2010, at 41–42; *see also Corporation Franchise Tax*, *supra* note 127, at 45–46.

¹⁵¹ Butler, *supra* note 128, at 106–07.

¹⁵² Some scholars appropriately question whether government revenue is a material benefit of increasing local incorporations. *See Kahan & Kamar, supra* note 88, at 728–29. However, as noted throughout, other benefits including lower cost of capital are present to attract investors and improve Ohio's business climate.

¹⁵³ *E.g.*, ISS PROXY ADVISORY SERVS., *supra* note 14, at 4–6 (Abercrombie cited strengthening its ties with Ohio as a reason for reincorporation in Ohio).

¹⁵⁴ Easterbrook & Fishel, *supra* note 18, at 1174; Kobayashi & Ribstein, *supra* note 18, at 1173–74.

¹⁵⁵ Kobayashi & Ribstein, *supra* note 18, at 1174; Winter, *supra* note 30, at 259; *see Ribstein, supra* note 87, at 390–91.

addition to substantive law, other factors surrounding Ohio's legal environment of business are important to attracting corporate charters.¹⁵⁶

While Delaware reaps considerable benefits as the leader in U.S. corporate law, there are several barriers to entry that discourage vigorous competition from other states. Nonetheless, due to a home-state bias for incorporations that gives states an edge when competing for in-state firms,¹⁵⁷ states may compete for in-state firms without challenging Delaware's position as the leader in state corporate law. It is the home-state bias and targeted competition to incorporate local firms in Ohio that provides the link between incorporation and the benefit to Ohio's business environment. This section will explain both deterrents to challenging Delaware as the leader for state corporate law and why Ohio should pursue limited competition for corporate charters, targeting in-state firms.

1. *Deterrents to Competing with Delaware for Corporate Charters*

There are several factors deterring other states from competing with Delaware as the leader in state corporate law.¹⁵⁸ First, "network externalities" make competition with Delaware difficult. Network externalities in corporate law arise from both "interpretive externalities" and "legal service externalities."¹⁵⁹ Interpretive externalities benefit Delaware case law because its many diverse firms provide vast opportunities through litigation for Delaware courts to address current corporate law issues in a timely manner.¹⁶⁰ Legal service externalities benefit Delaware because many lawyers specialize in Delaware corporate law, therefore creating market competition to lower legal services expenses associated with obtaining information.¹⁶¹

Second, Delaware has corporate law infrastructure, which would require competing states to make significant up-front investment in infrastructure to compete. Because of expert courts and judges, the excellent service its Secretary of State's Office provides and a vast legal

¹⁵⁶ Daines, *supra* note 28, at 1566–67; *see discussion supra* Part III.B.

¹⁵⁷ Daines, *supra* note 28, at 1562, 1575; *see also* Bebchuk & Cohen, *supra* note 1, at 387.

¹⁵⁸ In fact, competing with Delaware is so difficult that some commentators suggest only a federal charter could compete with Delaware. Bebchuk & Hamdani, *supra* note 32, at 613 ("[federal] competitor might add substantially to the competitive threat facing Delaware"); Roe, *supra* note 138, at 148–49.

¹⁵⁹ Bebchuk & Hamdani, *supra* note 32, at 586 (citing Michael Klausner, *Corporations, Corporate Law and Networks of Contracts*, 81 VA. L. REV. 757, 843–44 (1995)).

¹⁶⁰ *Id.* at 586–87.

¹⁶¹ *Id.*; *see also* Black, *supra* note 132, at 7–8.

services infrastructure, Delaware is well-positioned as the state leader in corporate law.¹⁶² Other states do not have this infrastructure and would need to make considerable up-front investment, constituting sunk costs, to attempt to compete with Delaware.¹⁶³

Third, states are not able to compete with price competition for corporate charters.¹⁶⁴ Price competition is only effective among products with similar quality, which is not the case with corporate law.¹⁶⁵ In addition, providing reduced franchise fees to attract corporate charters is not likely to be effective among large publicly-traded firms because franchise fees are usually insignificant relative to firm value.¹⁶⁶ Similarly, franchise fees do not provide significant revenues to state governments.¹⁶⁷

Finally, Delaware may simply react to other states threatening to challenge them in the race for corporate charters. If another state developed an innovative corporate law provision, for example, Delaware could simply provide law mirroring that provision or otherwise addressing a current issue to maintain its leading position.¹⁶⁸ For the foregoing reasons, there are significant obstacles to challenging Delaware's leading position in the market for corporate law.¹⁶⁹

2. *Ohio's Limited Form of Competition*

Notwithstanding Delaware's seemingly insurmountable lead in the market for corporate law, Ohio should compete to have firms located in Ohio incorporate in Ohio. The bias local firms have for their home state provides a good reason for states to compete for those local firms.¹⁷⁰ Ohio has a particularly strong basis for engaging in this limited form of competition because its corporate law is currently so complex, extreme and has not been shown to attract charters more so than more typical statutes

¹⁶² Bebachuk & Hamdani, *supra* note 32, at 586–88.

¹⁶³ *See id.*

¹⁶⁴ *Id.* at 589–90.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 590 (citing Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1225 (2001)).

¹⁶⁷ Kahan & Kamar, *supra* note 88, at 688–89.

¹⁶⁸ Bebachuk & Hamdani, *supra* note 32, at 593–95.

¹⁶⁹ Scholars recognize that Delaware's dominance is generally secure, but not insurmountable. *E.g., id.* at 586 (“It is worth stressing that the structural features analyzed below do not absolutely rule out any future challenge to Delaware's dominance by another state.”); Kahan & Kamar, *supra* note 88, at 724–25 (“Even absent a change in economic fundamentals, it is entirely plausible that an enterprising governor will in the future revamp her state's corporate law, establish a specialized court, and go after a portion of Delaware's profits.”).

¹⁷⁰ Daines, *supra* note 28, at 1562; *see also* Bebachuk & Cohen, *supra* note 1, at 387.

catering to management interests.¹⁷¹ In fact, leading corporate law scholars have “blacklisted Ohio as extreme.”¹⁷² As will be explained in Part IV, Ohio indeed has excessive antitakeover regulation as well as other statutes that are extreme and drafted in a complex manner.

Ohio should compete for in-state firms because Ohio incorporation will lower the cost of capital to Ohio firms and promote efficient companies,¹⁷³ which is a benefit that does not require competing with Delaware to be the dominant state for corporate charters. Again, Abercrombie’s recent attempt to reincorporate in Ohio is strong evidence that Ohio corporate law is materially harming Ohio’s business environment with excessive management protection: Abercrombie is an Ohio-based company that failed to incorporate in Ohio because of Ohio corporate law. Moreover, such evidence is rare because firms rarely attempt to reincorporate in Ohio. The author is aware of only one other instance in which a firm attempted to reincorporate in Ohio since Ohio adopted its 1986 reforms: Scotts, Inc. successfully reincorporated from Delaware to Ohio in 1994.¹⁷⁴ The fact that firms rarely reincorporate in Ohio cuts against arguments that Ohio is a desirable incorporation choice. Part III demonstrated that there is reason for Ohio to engage in limited competition for corporate charters; Part IV will build upon that with proposed resolutions to specific statutory issues under Ohio corporate law.

IV. ANALYZING STATUTORY ISSUES IN TITLE XVII OF THE OHIO REVISED CODE

Specific statutory issues persist throughout Title XVII of the Ohio Revised Code for corporate law and securities regulation. In many instances, laws are either unnecessarily complex, lack policy rationale or both. Some terminology, for example, dates back to 1927 and lacks policy rationale as an outlier from comparative state corporate law.¹⁷⁵ The rules of a corporation are called “regulations” in Ohio despite being called “bylaws”

¹⁷¹ Subramanian, *supra* note 1, at 1860–61.

¹⁷² Bebchuk & Cohen, *supra* note 1, at 387; see Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 546 (2001).

¹⁷³ See Ryngaert & Netter, *supra* note 19, at 376.

¹⁷⁴ The Scotts Co., Proxy Statement for Special Meeting of Stockholders (Form 10-K/A) (Sept. 20, 1994); The Scotts Co., Annual Report (Form 10-K/A) (Sept. 30, 1995) (“On September 20, 1994, the shareholders voted to reincorporate Scotts from Delaware to Ohio.”).

¹⁷⁵ Ohio adopted a general corporation law in 1927. General Corporation Act, No. 11, 1927 Ohio Laws 9. The terms “regulation” and “bylaw” persist today under the same meaning they carried under the 1927 general corporate law. *Compare id.* § 8623-12, with OHIO REV. CODE ANN. § 1701.11 (West 2009) (defining regulations); *compare* § 8623-61, with § 1701.59(A) (defining bylaws).

in the vast majority of jurisdictions.¹⁷⁶ By contrast, Ohio “bylaws” are specific rules that affect board of director duties.¹⁷⁷

But the provisions that are most important to shareholder wealth, the cost of capital and firms’ decisions where to incorporate address the relationship between shareholders and management because corporate law is designed to address agency costs.¹⁷⁸ In fact, agency costs are so important that business combinations primarily create value by reducing agency costs.¹⁷⁹ Specific provisions addressing the management-shareholder relationship include antitakeover, fiduciary duty and shareholder voting provisions.¹⁸⁰

In addition to substantive default provisions that strike a balance between management and shareholder interests, corporate law should provide clarity and, in many instances, discretion to change charter provisions and bylaws.¹⁸¹ Mandatory rules constrain firms with high agency costs, where, for example, shareholders prefer alternatives to antitakeover statutes for monitoring management in change of control situations, perhaps due to the nature of the firm.¹⁸² Also, statutory complexity gives rise to professional services costs, including legal fees that may otherwise be avoided.¹⁸³ With this focus, Ohio should adopt less complex statutes and revisit policy discussions regarding corporations, LLCs and securities regulation.

A. Corporations—Chapter 1701

Ohio’s general corporation law should be revised to provide a cohesive balance between management and shareholder interests. Ohio corporate law is founded upon a very dated structure that has since been consistently amended to accommodate management interests. Unfortunately, the resultant patchwork structure lacks cohesion and is difficult to understand

¹⁷⁶ § 1701.11.

¹⁷⁷ § 1701.59(A).

¹⁷⁸ Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1396 & n.6 (1989); Bebchuk, *supra* note 33, at 1465 (noting “significantly redistributive issues” in corporate law, which affect the relationship between shareholders and management).

¹⁷⁹ Easterbrook & Fischel, *supra* note 18, at 1173–74 (identifying reduced agency costs as increasing value).

¹⁸⁰ See Bebchuk, *supra* note 33, at 1396 n.6.

¹⁸¹ Easterbrook & Fischel, *supra* note 63, at 1420 (arguing that corporate charters and bylaws should reflect individual firm preferences).

¹⁸² Kobayashi & Ribstein, *supra* note 18, at 1167, 1172–74; Ribstein, *supra* note 87, at 390–91; Winter, *supra* note 30, at 259.

¹⁸³ Macey & Miller, *supra* note 90, at 504–05 (noting that the Delaware Bar may favor complex corporate law rules that will be unattractive to firms wishing to avoid litigation costs).

when compared to corporate law in other states such as Delaware.¹⁸⁴ Ohio should reform its general corporation law starting from a neutral basis, such as the Revised Model Business Corporation Act (RMBCA),¹⁸⁵ with amendments made only to implement thoughtful policy in a straightforward manner.

Ohio corporate law today reflects patchwork amendment to Ohio's 1955 general corporate law. The Ohio Constitution, adopted in 1851, authorizes the Ohio General Assembly to enact a general corporation law, rather than requiring special legislation to create business entities.¹⁸⁶ In 1852, the Ohio General Assembly adopted a general corporation law, which required corporations to be created for a statutorily enumerated purpose, and provided different corporate laws depending on such purpose.¹⁸⁷ In 1927, Ohio adopted a new general corporation law, including a provision authorizing corporations to be created for any purpose.¹⁸⁸ Ohio re-codified all Ohio laws and adopted the present-day Ohio Revised Code in 1953. Shortly thereafter, in 1955, Ohio adopted its present-day general corporation law.¹⁸⁹

Many changes have been made to Ohio corporate law since 1955, including antitakeover legislation discussed *infra*, but some of the most notable changes took place in 1986 amendments.¹⁹⁰ As background, Ohio adopted a constituency statute in 1985 that allowed Ohio directors to take non-shareholder interests into account in pursuing the corporation's best interests.¹⁹¹ Under director fiduciary responsibility laws prior to 1986

¹⁸⁴ See Carney, *supra* note 35, at 736, 755 ("corporate law has a strong tendency toward uniformity, but . . . all corporate laws are not identical"). Nonetheless, Professor Carney's study showed that Ohio was one of only seven states that did not adopt selected provisions of Model Business Corporation Act. *Id.* at 743–44 tbl.2.

¹⁸⁵ MODEL BUS. CORP. ACT (2010).

¹⁸⁶ OHIO CONST. art. XIII, § 2.

¹⁸⁷ Act of May 1, 1852, vol. 50, § 73, 1852 Ohio Laws 272, 295; *e.g.*, Act of May 3, 1878, § 9, 1878 Ohio Laws 128, 129 (authorizing wool growers associations to organize as corporations).

¹⁸⁸ General Corporation Act, No. 11, § 8623-3, 1927 Ohio Laws 9, 10. According to Professor Ballantine, the 1927 Ohio General Corporation Act was among the best in the country at the time and served as a model for the Uniform Business Corporation Act. Henry Ballantine, *Recent Legislation: Legislative Developments in Corporation Law*, 15 CALIF. L. REV. 422, 422 (1927).

¹⁸⁹ Act effective Aug. 1, 1955, No. 32, 1955 Ohio Laws 432 (revising and renumbering the general corporation law).

¹⁹⁰ Act effective Nov. 22, 1986, No. 278, 1986 Ohio Laws 6107 (amending parts of the general corporation law).

¹⁹¹ Act effective Oct 10, 1984, No. 251, § 1701.59, 1984 Ohio Laws 2751, 2752; OHIO REV. CODE ANN. § 1701.59 (West Supp. 2012).

reform, Ohio directors enjoyed significant protection from shareholder litigation for breaching their fiduciary duties.¹⁹²

The 1981 battle for control over Marathon Oil Company, which resulted in a merger with U.S. Steel Corporation, one of the largest mergers in the United States at that time, provides context to explain director fiduciary responsibility in Ohio prior to 1986. In *Radol v. Thomas*, the U.S. Sixth Circuit Court of Appeals considered whether the Marathon board of directors (i.e. the target board) breached their fiduciary duties owed to shareholders in negotiating the merger.¹⁹³ U.S. Steel, acting as a white knight, agreed to leave the existing Marathon board in place following the merger, thereby providing a job-security benefit to target management that did not accrue to target shareholders.¹⁹⁴ Despite directors' conflicting loyalties because of their self-interest in staying on the board, the trial court instructed the jury that the directors did not breach their fiduciary duties unless they "committed fraud, or intentionally acted contrary to the best interest of the corporation and the shareholders."¹⁹⁵ Moreover, the court rejected the plaintiffs' arguments that "in the context of corporate control transactions the burden of proof shifts to the directors to establish the fairness to shareholders of any transaction that would have the effect of retaining the directors' control."¹⁹⁶ Ohio directors, therefore, enjoyed considerable discretion in managing the corporations' affairs prior to 1986.

Despite Ohio directors' strong protection under contemporary Ohio corporate law, Ohio adopted sweeping amendments in 1986 to depart from comparative corporate law.¹⁹⁷ These amendments relaxed director fiduciary

¹⁹² *Radol v. Thomas*, 772 F.2d 244, 256–58 (6th Cir. 1985).

¹⁹³ *Id.* at 256.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* The court further explained the business judgment rule and fiduciary duties in Ohio prior to 1986:

The Ohio formulation of these duties was codified in 1984 in O.R.C. § 1701.59(B), and under the duty of loyalty, a "director shall perform his duties as a director . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation," while under the duty of care, a director must perform his duties "with the care that an ordinary prudent person in a like position would use under similar circumstances." Moreover, in evaluating a director's compliance with the duty of care, Ohio courts adhere to the "business judgment rule," and will not inquire into the wisdom of actions taken by the directors in the absence of fraud, bad faith or abuse of discretion.

Id.

¹⁹⁶ *Id.* at 257.

¹⁹⁷ See OHIO REV. CODE ANN. § 1701.59(F) (West Supp. 2012); see also Deborah Cahalane, *Ohio Corporation Amendments: Expanding the Scope of Director Immunity*, 56 U. CIN. L. REV. 663, 663–64 (1987); Oesterle, *supra* note 19, at 910–

duties to the point of non-existence,¹⁹⁸ provided excessive advancement and indemnification for directors¹⁹⁹ and adopted a statute authorizing poison pills.²⁰⁰

The 1986 amendments were likely a response to contemporary events rather than legislation grounded in thoughtful policy rationale. First, the antitakeover legislation was a reaction to the threatened takeover of Goodyear Tire & Rubber Co.²⁰¹ Second, at least one contemporary case in another jurisdiction held directors liable for breaching fiduciary duties likely propelled the legislation.²⁰² Specifically, in the Delaware case *Smith*

13. Critics of the '86 amendments argue that the director protections were designed to give directors nearly unlimited control over corporate governance. See discussion *infra* Part IV.A.2. On the other hand, proponents point to a development in comparative corporate law, namely *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), that subjected directors to liability. Morgan Shipman, *Regulating Corporate Takeovers: The Case for Reasonable State Regulation of Corporate Takeovers: Some Observations Concerning the Ohio Experience*, 57 U. CIN. L. REV. 507, 519 (1988). Professor Shipman often addressed the Ohio General Assembly concerning corporate law and takeover regulation, "representing the Corporate Law Committee of the Ohio State Bar Association and in an individual capacity." *Id.* at 507. After *Van Gorkom*, statutory director protection, so the argument goes, was necessary to attract good directors and compete among states for corporate charters. See § 1701.59 cmt. (1986).

It is believed to be important for corporations to be able to obtain and retain those persons who can best serve as directors. It is also important that the directors of corporations feel free to use their best judgment in making business decisions that are in the best interest of the corporation and its shareholders without undue concern for personal liability. It is also believed that it is important for corporations to be able to attract and retain "outside" (non-management) directors who are in a position to provide independent judgment. The amendments to Sec. 1701.59 are designed to help achieve these goals.

Id. In Ohio, a threatened takeover of Goodyear Tire & Rubber Co. was likely the proximate cause of the '86 amendments. Ryngaert & Netter, *supra* note 19, at 373.

¹⁹⁸ See discussion *infra* Part IV.A.2.

¹⁹⁹ § 1701.13(E); *Miller v. Miller*, Slip Opinion No. 2012-Ohio-2928 (Ohio July 3, 2012) (upholding an Ohio director's advancement rights); see also Porter, *supra* note 10, at 185 n.56; Edward Schrag, Robert Lautzenhiser & Shawn Flahive, *Director and Officer Liability and Indemnification: The Ohio Approach*, 20 U. TOL. L. REV. 1, 38–67 (1988) (extensively discussing indemnification and related matters for Ohio directors).

²⁰⁰ § 1701.16(B); see discussion *infra* Part IV.A.3.

²⁰¹ Carney, *supra* note 35, at 751 tbl 3; Ryngaert & Netter, *supra* note 19, at 373.

²⁰² See Schrag, Lautzenhiser & Flahive, *supra* note 199, at 11–16; see also Shipman, *supra* note 197, at 519, 533 ("Section 1701.59(D) is a necessary adjustment of state law in light of the harsh liability-generating principles of *Smith*

v. Van Gorkom, the directors of Trans Union Corporation breached their duties to shareholders by accepting a merger proposal despite obtaining information from experts and holding a shareholder ratification vote to approve the deal.²⁰³

As a result of the 1986 amendments, shareholder wealth in Ohio has measurably declined.²⁰⁴ Quite simply, historical circumstances that led to patchwork Ohio corporate law removed from sound policy rationale does not justify Ohio corporate law today. This section provides additional historical context and discusses specific Ohio corporate law issues with the following most important provisions to shareholder wealth and firm cost of capital: (1) shareholder voting provisions; (2) director fiduciary responsibility provisions; and (3) antitakeover regulation.

1. *Shareholder Voting*

Inconsistent shareholder voting rules under Ohio corporate law should be revised to better align with other provisions. State corporate codes are "enabling statutes" that set default rules to be altered by corporate charters and bylaws ("regulations" in Ohio) if desired, of course within the bounds of statutory authority.²⁰⁵ However, shareholder voting in Ohio is inconsistent inasmuch as some voting provisions grant shareholders considerable control whereas other provisions make it difficult for shareholders to act. In instances where it is difficult to act, including amending the corporate charter, shareholder voting rules add an additional layer of management protection and decrease shareholder wealth, because companies have little flexibility to opt out of default provisions that give management considerable discretion.²⁰⁶

As noted, the 1955 Ohio General Corporation Act persists today, as amended with patchwork updates that have resulted in complex and extreme statutes. Particularly important are arcane shareholder voting

v. Van Gorkom."'). As of this writing, the Ohio Revised Code section Professor Shipman cites is now codified at section 1701.59(E).

²⁰³ *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985). The Delaware Supreme Court stated that the Trans Union directors' reliance on experts was not reasonable under the circumstances and that shareholders were not sufficiently informed to approve the deal. *Id.* at 877, 891-93. Casual board procedure, the failure to obtain an appraisal study and the failure to vet the offer in the market may have led to the court's finding in *Van Gorkom*. See, e.g., *id.* at 877.

²⁰⁴ Ryngaert & Netter, *supra* note 19, at 374.

²⁰⁵ Easterbrook & Fischel, *supra* note 63, at 1416-17.

²⁰⁶ See Gregg Jarrell & Annette Poulsen, *Shark Repellents & Stock Prices*, 19 J. FIN. ECON. 127, 131-32, 155 (1987) ("The non-fair-price amendments, which include the two categories of supermajority, authorization-of-preferred-stock, and classified-board amendments, show a negative and statistically significant average abnormal return of 3.0%.").

provisions that date back to 1927 and reflect policy implemented at a time when corporations existed in a vastly different regulatory environment.²⁰⁷ Each of the three shareholder voting provisions highlighted in this section—amending the corporate charter, cumulative voting and the quorum requirement—date back to the 1927 Ohio General Corporation Act, but only the cumulative voting provision has been materially amended.²⁰⁸

First, Ohio corporate law provides default rules making it difficult to amend the corporate charter and regulations, which makes it difficult for shareholders to collectively act.²⁰⁹ To amend the corporate charter, most states require that directors propose charter amendments, which shareholders must ratify, usually by a majority vote.²¹⁰ Ohio, on the other hand, does not require that the board propose charter amendments, but does authorize shareholders to unilaterally amend the charter with a two-thirds supermajority shareholder vote.²¹¹ This unusual rule is both too broad (i.e. shareholders may unilaterally amend) and too narrow (i.e. supermajority approval) for shareholders to opt out of default charter provisions that provide tremendous management protection.²¹² Further, the supermajority default rule for amending the corporate charter makes amendment more

²⁰⁷ OHIO REV. CODE ANN. §§ 1701.4–.5 (West 2009); *see also* discussion *infra* Part IV.A.1. The 1927 Ohio Act predated the Great Depression, the Securities Act of 1933, the Exchange Act of 1934 and the Investment Company Act of 1940, among other major regulatory legislation.

²⁰⁸ General Corporation Act, No. 11, §§ 8623-15, 8623-48, 8623-50, 1927 Ohio Laws 9, 14–16, 30–31; § 1701.55 (cumulative voting); § 1701.62 (quorum requirement for shareholder meeting to elect the board of directors); § 1701.71 (amending the charter). In addition, the provision that allows for shareholder action without a meeting, but only with unanimous approval, dates to 1927 and is too onerous to be practically useful. § 1701.11(C); Davidoff, *supra* note 4 (“But this written consent is required to be unanimous except for amending Abercrombie’s articles. This is impossible to obtain in a public corporation.”).

²⁰⁹ Jeffrey Gordon, *Contractual Freedom in Corporate Law: The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1583 (1989).

²¹⁰ *E.g.*, DEL. CODE ANN. tit. 8, § 242 (West 2010); MODEL BUS. CORP. ACT § 10.03 (2010).

²¹¹ § 1701.71; Porter, *supra* note 23, at 661 n.114. On a related note, a two-thirds supermajority of shareholders is required to make other changes. *E.g.*, § 1701.31 (reduction of state capital); § 1701.76 (asset sale); § 1701.78 (merger). The Ohio provision requiring a two-thirds supermajority vote to approve an acquisition is very unusual as most states, recognizing supermajority approval as too onerous, require only majority shareholder approval. OESTERLE, *supra* note 22, at 33.

²¹² *E.g.*, § 1701.59(E) (“This division does not apply if, and only to the extent that, at the time of a director’s act or omission that is the subject of complaint, the articles or the regulations of the corporation state by specific reference to this division that the provisions of this division do not apply to the corporation.”).

costly and can provide minority shareholders with hold-up power that enables them to extract side payments.²¹³

In addition, Ohio has an unusual provision that does not permit directors to unilaterally amend the regulations, except with regard to minor provisions.²¹⁴ Issues arise because it is difficult for the board of directors to be nimble and act in the corporation's best interests.²¹⁵ A special shareholder vote must be held to authorize director proposals to amend the regulations.²¹⁶ In some situations, the board may have to wait several months for an annual meeting to amend regulations when immediate action is necessary.²¹⁷ To provide for more nimble and efficient firms, Ohio should adopt a rule allowing shareholders to authorize boards of directors to unilaterally amend corporate regulations.²¹⁸

Second, Ohio's cumulative shareholder voting provision²¹⁹ may be undesirable. Cumulative voting implements an election structure where each share has as many votes as there are candidates for director, and the

²¹³ Gordon, *supra* note 209, at 1583–84.

²¹⁴ § 1701.11(A)(1) (requiring shareholder approval in many situations to amend corporate regulations); § 1701.10 (permitting the Board to adopt regulations within ninety days of incorporation). Recent legislation has made it possible for the board of directors to amend the regulations in some respects. § 1701.11(C); H.B. 301, 126th Gen. Assemb., Reg. Sess. (Ohio 2006). Nonetheless, shareholders may not authorize the board to unilaterally amend the regulations in many material respects. Porter *supra* note 10, at 189–90 (citing code sections which require shareholder approval to amend the regulations). The board may amend the corporate charter in limited situations. § 1701.70.

²¹⁵ Porter, *supra* note 10, at 188.

²¹⁶ § 1701.11(A); *see also* Porter, *supra* note 10, at 188 (“Ohio has long stood apart from other states by requiring any changes to the regulations (called ‘bylaws’ in Delaware and many other states) to be approved by shareholders.”). But *see* section 1701.11(A)(1)(d), which provides for director amendment in the following circumstance:

If and to the extent that the articles or regulations so provide or permit and unless a provision of the Revised Code reserves such authority to shareholders, by the directors, provided that no provision or permission in the articles or regulations may divest shareholders of the power, or limit the shareholders’ power, to adopt, amend, or repeal regulations.

§ 1701.11(A)(1)(d).

²¹⁷ For companies with articles of incorporation that do not authorize electronic proxies, as permitted in Ohio by 1999 legislation, the Board may have to wait until an annual meeting to make necessary corporate changes. Porter, *supra* note 10, at 188–90.

²¹⁸ *E.g.*, DEL. CODE ANN. tit. 8, § 109 (West 2010); REV. MODEL BUS. CORP. ACT § 10.20(b) (2010).

²¹⁹ § 1701.55.

votes may be concentrated among particular directors.²²⁰ As such, a default cumulative voting rule permits gamesmanship in electing corporate directors. Again, companies may be inflexible because current Ohio law requires a provision in a corporate charter or amendment by supermajority shareholder vote to eliminate cumulative voting.²²¹ Ohio's default rule should be non-cumulative voting with an opt in election if the firm decides to give minority shareholders a greater voice in electing directors.²²²

Third, there is effectively no shareholder quorum requirement despite the express codification of a "quorum requirement."²²³ Defining a quorum to be those present at a meeting is effectively no quorum at all. The absence of a quorum requirement promotes gamesmanship in corporate governance by permitting corporate action by only those shareholders present at a meeting. To be sure, most voting matters have a quorum requirement that is specially designated for that matter.²²⁴ Nonetheless, a more appropriate rule would require a majority of the shares entitled to vote to be present for a shareholder vote.²²⁵ For these reasons, voting provisions under Ohio corporate law should be revised accordingly.

2. Director Fiduciary Responsibility

Ohio directors have little fiduciary responsibility to shareholders and other stakeholders due to extreme and complex law. To be sure, Ohio directors should have considerable discretion to make business decisions and conduct corporate affairs under the business judgment rule, but they should not have nearly unlimited discretion that removes meaningful accountability to shareholders. Without meaningful director accountability to any stakeholders, a state's corporate law is antithetical to the notion that fiduciary duties allow shareholders, or even other stakeholders, to monitor corporate affairs.²²⁶ Concerns about accountability are particularly acute in situations where management has personal interests that do not align with

²²⁰ *E.g., id.* § 1701.55(D).

²²¹ *Id.* § 1701.55(C). Shareholders' right to cumulative voting is subject to notice requirements. *Id.*

²²² *See, e.g.,* DEL. CODE ANN. tit. 8, §§ 212, 214 (West 2010); REV. MODEL BUS. CORP. ACT § 7.28(b) (2010).

²²³ *See* § 1701.51(A).

²²⁴ § 7.25 cmt. n.2 ("Implicit in section 7.25 is the concept that the determination of the voting groups entitled to vote, and the quorum and voting requirements applicable thereto, must be determined separately for each 'matter' coming before a meeting. As a result, different quorum and voting requirements may be applicable to different portions of a meeting, depending on the matter being considered.").

²²⁵ *E.g.,* § 7.25 (defining a quorum as a majority of shares entitled to vote on the matter). *But see* tit. 8, § 216 (defining a quorum as the shares present for most matters other than electing directors).

²²⁶ Easterbrook & Fischel, *supra* note 18, at 1191.

firm interests, for example, when making executive compensation decisions or during corporate control change situations.

i. *Director Duties of Care and Loyalty Under Current Ohio Law*

Ohio corporate law excessively curtails both the fiduciary duty of care and duty of loyalty.²²⁷ First, the fiduciary duty of care is codified in Ohio,²²⁸ but other provisions effectively eliminate its substance in a complex manner.²²⁹ Section 1701.59(B) adopts an “ordinarily prudent person” standard to determine whether a director’s business decisions are protected under the business judgment rule. In most other states, the business judgment rule affords directors more protection under a gross negligence standard.²³⁰ Moreover, Ohio’s objective prudent person standard lacks clarity because it is often unclear how a prudent person, or prudent corporate director, would behave in fact-specific situations.²³¹ Further, courts reviewing business decisions for prudence after the fact may take hindsight into account (i.e. second-guess business decisions). By contrast, a

²²⁷ § 1701.59; see Subramanian, *supra* note 1, at 1827 (stating that some states have adopted *de facto* constituency statutes indirectly through fiduciary duty provisions); Porter, *supra* note 23, at 635–36 (noting that the Ohio business judgment rule has been “codified and strengthened”).

²²⁸ § 1701.59(B). Under Ohio law, the fiduciary duty of care is defined, in pertinent part, as follows:

A director shall perform the director’s duties as a director, including the duties as a member of any committee of the directors upon which the director may serve, in good faith, in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation, and with the care that an *ordinarily prudent person* in a like position would use under similar circumstances.

Id. (emphasis added).

²²⁹ Porter, *supra* note 23, at 635–36.

²³⁰ *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 750–51 (Del. Ch. 2005) (stating that the duty of care holds corporate fiduciaries to a gross negligence standard); Dalia Tsuk Mitchell, *Status Bound: The Twentieth Century Evolution of Directors’ Liability*, 5 N.Y.U. J. L. & BUS. 63, 123 (2009) (“By the mid 1980s, the Delaware courts collapsed the duty of care into the business judgment rule; they declared that the business judgment rule altered the standard of care from negligence to gross negligence and made gross negligence a prerequisite for rebutting the presumption of the business judgment rule. Within a few years, these ideas were strongly cemented into U.S. corporate law.”).

²³¹ The term “objective” is used here to describe a behavioral standard based upon a third person (i.e. a prudent person). However, the “prudent person” standard is still subjective inasmuch as a judge’s subjective view affects the standard when multiple judges are unable to reach consensus as to what constitutes a prudent person’s behavior in a particular situation.

subjective business judgment rule requiring a director to “act in accordance with his/her good faith business judgment of what is in the best interests of the corporation” maintains deference to directors and provides more clarity than the prudent person standard.²³² Ohio’s business judgment rule provides additional management protection in damages actions, where Ohio law requires intentional or reckless disregard of the best interests of the corporation to hold directors liable.²³³

Despite the unusually low negligence (i.e. ordinarily prudent person) standard for the Ohio business judgment rule, other provisions buttress Ohio’s business judgment rule to grant directors considerable discretion. The burden of proof for a breach of fiduciary duty is the clear and convincing standard, which is higher than the typical preponderance of the evidence standard.²³⁴ More importantly, Ohio’s constituency provision, one of the broadest in the nation, effectively nullifies the fiduciary duty of care.²³⁵ Under Ohio’s constituency provision, which rejects shareholder primacy principles and the Delaware *Revlon* doctrine,²³⁶ directors may consider such broad interests in determining the best interests of the corporation that they effectively must consider no interests—including shareholder interests.²³⁷ In sum, the duty of care combined with Ohio’s constituency provision provides excessive discretion to Ohio directors conducting corporate affairs, and does so in an odd manner.

²³² *E.g.*, Willard *ex rel* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 284 (Va. 1999) (“The contrast between the provisions of Code § 13.1-690 and those contained in § 8.30 of the RMBCA convinces us that, in Virginia, a director’s discharge of duties is not measured by what a reasonable person would do in similar circumstances or by the rationality of the ultimate decision. Instead, a director must act in accordance with his/her good faith business judgment of what is in the best interests of the corporation. Thus, the *Revlon* test is not applicable in Virginia.”).

²³³ § 1701.59(E).

²³⁴ *Id.* § 1701.59(D)–(E); *see also* Schrag, Lautzenhiser & Flahive, *supra* note 199, at 22 (explaining the clear and convincing standard for proving Ohio fiduciary duties).

²³⁵ *Id.* § 1701.59(F).

²³⁶ In Delaware, directors are required to act in the best interests of shareholders rather than a multitude of constituency interests. *Revlon v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

²³⁷ § 1701.59(F) (“[A] director, in determining what the director reasonably believes to be in the best interests of the corporation, shall consider the interests of the corporation’s shareholders and, in the director’s discretion, may consider any of the following: (1) The interests of the corporation’s employees, suppliers, creditors, and customers; (2) The economy of the state and nation; (3) Community and societal considerations; (4) The long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.”).

Second, the duty of loyalty is excessively curtailed under Ohio law.²³⁸ Ohio's duty of loyalty is codified as a safe harbor to uphold actions authorized by conflicted directors if conflicts are disclosed, informed shareholders approve a transaction or a transaction is fair.²³⁹ To bring a duty of loyalty claim in these situations, however, plaintiffs bear some nontrivial burden to show that directors are "interested" or engaged in self-dealing.²⁴⁰ Then, the burden shifts to directors to vindicate their behavior with one of the affirmative defenses in section 1701.60.²⁴¹

Under this framework for the Ohio duty of loyalty, directors maintain business judgment rule protection, even when making decisions that may result in a change of control or a termination of the director's service.²⁴² Further, directors may be outside the scope of the duty of loyalty even if making self-interested decisions affecting their own compensation.²⁴³ In Delaware, by contrast, directors are treated as inherently conflicted and

²³⁸ *Id.* § 1701.60. Under Ohio law, the fiduciary duty of loyalty is designed to prevent directors from yielding to the pressure of conflicts of interests in performing their duties. *See id.* § 1701.60(A).

²³⁹ *Id.* § 1701.60(A).

²⁴⁰ *Id.* §§ 1701.59(D)(1), 1701.60(C); *see also* Schrag, Lautzenhiser & Flahive, *supra* note 199, at 24 ("The only exception to this one-way application of the burden of proof may occur when the director's conduct involves self-dealing. In the case of a transaction in which the plaintiff has shown that a director has a personal interest, the burden of proof may shift to the director to establish one of the 'defenses' set forth in section 1701.60 (e.g., that the transaction was 'fair' to the corporation); Shipman, *supra* note 197, at 534-35. At least one court has had difficulty explaining the burden of proof under Ohio's duty of loyalty. *See* United States v. Skeddle, 940 F. Supp. 1146, 1150-53 (N.D. Ohio 1996) (discussing the burden of proof under section 1701.60 with an analogy to Delaware law). One interpretation is that section 1701.60 requires a plaintiff to show a duty of care violation in order to shift the burden of proof to directors, who then bear the burden of showing they met one of the safe harbor provisions under section 1701.60(A). *But see* § 1701.59(D)(3) ("Nothing contained in this division limits relief available under section 1701.60 of the Revised Code.").

²⁴¹ Schrag, Lautzenhiser & Flahive, *supra* note 199, at 24; Shipman, *supra* note 197, at 534-35.

²⁴² § 1701.60(C) ("For purposes of division (A) of this section, a director is not an interested director solely because the subject of the contract, action, or transaction may involve or affect a change in control of the corporation or his continuation in office as a director of that corporation."). Further, section 1701.59(D), as amended, states that clear and convincing evidence of director actions not in the best interests of the corporation is required, even in the case of actions that may result in change of control or director termination. *Id.* § 1701.59(D); *see also* Schrag, Lautzenhiser & Flahive, *supra* note 199, at 25-27 (noting that Ohio rejected Delaware's *Unocal* doctrine, in which interested directors are closely scrutinized for fiduciary responsibility).

²⁴³ § 1701.60(A)(3).

closely scrutinized in these situations.²⁴⁴ As a result, Ohio directors may escape accountability for decisions relating to interested transactions that may be better monitored with a stronger duty of loyalty. But it is far from clear that a self-interested manager (e.g., one resisting a tender offer) should be accorded the same deference as a manager in good standing.²⁴⁵

The main context in which Ohio directors will be shielded from litigation, but would not be in Delaware, is in certain situations where there is an imminent change in corporate control and competing bidders for the firm—the so-called *Revlon* Zone. In Delaware, when there is an imminent change in corporate control and competing bidders, the firm is deemed to be “in play” and directors have *Revlon* duties.²⁴⁶ In short, *Revlon* duties

²⁴⁴ Sections 1701.59(D) and 1701.60(C) essentially reject *Unocal* and its progeny under Delaware law, which set a threshold test to reach the protection of the business judgment rule in change of control situations. *Id.* §§ 1701.59(D); *see* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995) (“This Court has recognized that directors are often confronted with an ‘inherent conflict of interest’ during contests for corporate control ‘because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders.’ Consequently, in such situations, before the board is accorded the protection of the business judgment rule, and that rule’s concomitant placement of the burden to rebut its presumption on the plaintiff, the board must carry its own initial two-part burden” (citations omitted)); *Unocal* Corp. v. Mesa Petrol. Co., 493 A.2d 946 (Del. 1985); *see also* *Chesapeake Corp. v. Shore*, 771 A.2d 293, 328–29 (Del. Ch. 2000) (“As *Unocal* recognized, the possibility that management might be displaced if a premium-producing tender offer is successful creates an inherent conflict between the interests of stockholders and management.”).

²⁴⁵ Easterbrook & Fischel, *supra* note 18, at 1197–98 (distinguishing the duty of care and the duty of loyalty); *see, e.g.,* Oesterle, *supra* note 63, at 154–55 (arguing that the Delaware Supreme Court should have decided *Revlon* solely on duty of loyalty grounds).

²⁴⁶ *Revlon v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1986) (“Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter’s offer adversely affects shareholder interests, but when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions. Market forces must be allowed to operate freely to bring the target’s shareholders the best price available for their equity. Thus, as the trial court ruled, the shareholders’ interests necessitated that the board remain free to negotiate in the fulfillment of that duty.” (footnote omitted)); *see also* *Paramount Commc’ns v. QVC Network*, 637 A.2d 34, 43 (Del. 1994) (“Because of the intended sale of control, the Paramount-Viacom transaction has economic consequences of considerable significance to the Paramount stockholders. Once control has shifted, the current Paramount stockholders will have no leverage in the future to demand another control premium. As a result, the Paramount stockholders are entitled to receive, and should receive, a control premium and/or protective devices of significant value. There being no such

require directors to seek the transaction offering the best current value to shareholders.²⁴⁷ By contrast, Ohio's constituency statute²⁴⁸ and other laws

protective provisions in the Viacom-Paramount transaction, the Paramount directors had an obligation to take the maximum advantage of the current opportunity to realize for the stockholders the best value reasonably available The consequences of a sale of control impose special obligations on the directors of a corporation. In particular, they have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders.”).

²⁴⁷ *Revlon* duties require that directors make informed decisions to maximize shareholder value, but *Revlon* duties do not provide a “blueprint” that directors must follow. *Paramount*, 637 A.2d at 44 (“In determining which alternative provides the best value for the stockholders, a board of directors is not limited to considering only the amount of cash involved, and is not required to ignore totally its view of the future value of a strategic alliance.”); *see, e.g., Revlon*, 506 A.2d at 184 (“While Forstmann’s \$57.25 offer was objectively higher than Pantry Pride’s \$56.25 bid, the margin of superiority is less when the Forstmann price is adjusted for the time value of money. In reality, the Revlon board ended the auction in return for very little actual improvement in the final bid. The principal benefit went to the directors, who avoided personal liability to a class of creditors to whom the board owed no further duty under the circumstances.”). In stock or other non-cash consideration deals, for example, the target board should make informed efforts to quantify the value of competing offers. *QVC Network*, 637 A.2d at 44. In addition, target board behavior favoring one bidder over another, such as adopting unreasonable takeover defenses enabling such favoritism, may run afoul of *Revlon* duties:

When the Paramount directors met on November 15 to consider QVC’s increased tender offer, they remained prisoners of their own misconceptions and missed opportunities to eliminate the restrictions they had imposed on themselves. Yet, it was not “too late” to reconsider negotiating with QVC. The circumstances existing on November 15 made it clear that the defensive measures, taken as a whole, were problematic

Id. at 50. For additional discussion of *Revlon* duties from Delaware courts, see *Wells Fargo & Co. v. First Interstate Bancorp*, No. 14696, 1996 Del. Ch. LEXIS 3, at *13 n.3, (Del. Ch. Jan. 18, 1996), stating:

What I take to be distinctive about this state of affairs [when “*Revlon*” duties apply] is three things principally. *First*, in this situation the board must seek to achieve greatest available current value; it may not, in effect, trade achievable current value for a prospect of greater future value, as it may normally do in the exercise of its good faith business judgment. Historically, one would say that courts would be slow to impose this limitation except in limited circumstances. And indeed despite the fact that commentators tended to treat the *Revlon* case as revolutionary, recent cases have made clear that it did not deviate from this tradition very greatly. *Second*, when in this situation, a board’s duty to be informed will require it to fully consider alternative transactions offered by any responsible buyer. *Third*, in part

provide Ohio directors with more discretion in this context to sell the firm to bidders in transactions that do not maximize current shareholder value.

More specifically, fiduciary duty lawsuits in Delaware are more likely to result in *injunctive relief* that can delay or even enjoin deals. In recent years, some Delaware cases have granted plaintiffs preliminary injunctions that delay friendly transactions in the *Revlon* context.²⁴⁹ This distinction between Ohio and Delaware law is less potent in suits for *damages* because Delaware law allows firms to opt in to a heightened duty of care,²⁵⁰ and in fact most Delaware firms have elected to do so. Far from suggesting that Ohio should not reform its corporate law, however, this distinction between Ohio and Delaware law provides guidance for affirmatively reforming Ohio corporate law.

ii. *Recommendations for Reforming Ohio Director Fiduciary Duties*

In reforming director fiduciary responsibility, Ohio should promote deference to business decisions under the business judgment rule while effectively reinstating director duties of care and loyalty to shareholders. Notwithstanding shareholder primacy, management should have great discretion to conduct corporate affairs in most situations.²⁵¹ In the change of

“Revlon duties” are not distinctive board duties at all, but a changed standard of judicial review. That is when “Revlon duties” are triggered a burden will shift to the directors and the court will undertake more active review of the traditional directorial duties of care and loyalty under a reasonableness standard.

Id. (citations omitted). Delaware Courts have also adopted analytical steps to explain the *Revlon* doctrine. See generally *QVC Network*, 637 A.2d at 45 (“The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors’ action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.”).

²⁴⁸ § 1701.59(F).

²⁴⁹ E.g., *In re Del Monte Foods Corp.*, 25 A.3d 813, 844 (Del. Ch. 2011) (granting preliminary injunction for twenty days); *In re Netsmart Tech. Inc.*, 924 A.2d 171, 197, 209 (Del. Ch. 2007) (noting that there is a duty to auction and eventually granting a preliminary injunction pending adequate disclosure to shareholders); *In re Toys “R” Us*, 877 A.2d 975, 999, 1023 (Del. Ch. 2005) (holding that the *Revlon* duties did not create a preliminary injunction because the Board followed procedures).

²⁵⁰ DEL. CODE ANN. tit. 8, § 102(b)(7) (2010).

²⁵¹ Although most management decisions are protected under the business judgment rule, and the idea that benefitting non-shareholder stakeholders benefits

control context with multiple bidders—the *Revlon Zone*—where, as noted, there is a real-world distinction between Ohio and Delaware law, Ohio should provide fiduciary duties distinct from Delaware’s *Revlon* duties.²⁵² *Revlon* duties can be perceived to limit the target board’s role when there is an imminent change of control and multiple bidders, in which case director conduct may lead to litigation that holds-up or even enjoins deals altogether. Further, *Revlon* duties put directors in a more passive role that may deter them from actively negotiating in shareholders’ best interests.²⁵³

But target directors may play an active role in negotiating deals without abdicating their duty to shareholders. In other words, Ohio law can strike a middle ground between complete director passivity and the existing Ohio law, which is extremely deferential to directors. To do so, corporate law should delegate negotiation responsibility to directors under a framework that provides a balance between director discretion and shareholder accountability.²⁵⁴

A subjective business judgment rule requiring directors to make good faith business judgments in the best interests of the corporation may achieve these policy objectives.²⁵⁵ Ohio should also eliminate its constituency statute and provide a more general statute delegating authority to directors to act as duly elected representatives of shareholders.²⁵⁶ In addition, Ohio should lower the standard of proof from clear and convincing to the more typical preponderance of the evidence standard.

Under this approach, directors maintain considerable discretion to conduct corporate affairs. In the tender offer context, for example, directors may consider confidential non-public information about the firm to defeat

shareholders as well as residual claimants, management must still be able to make a good faith assertion that management decisions are designed to benefit shareholders in some way. *Revlon*, 506 A.2d at 182 (“A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.”).

²⁵² Oesterle, *supra* note 63, at 150–54 (distinguishing a negotiations model from Delaware law and *Revlon* duties).

²⁵³ But see *Revlon*, 506 A.2d at 184 n.16 (“By this we do not embrace the ‘passivity’ thesis rejected in *Unocal*. The directors’ role remains an active one, changed only in the respect that they are charged with the duty of selling the company at the highest price attainable for the stockholders’ benefit.” (citations omitted)).

²⁵⁴ Oesterle, *supra* note 63, at 121–22 (citing Leo Herzel, John R. Schmidt & Scott J. Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980)). But see Easterbrook & Fischel, *supra* note 18, at 1174–75.

²⁵⁵ E.g., *Willard ex rel. Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc.*, 515 S.E.2d 277, 284–85 (Va. 1999).

²⁵⁶ See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2010); *Paramount Commc’ns v. QVC Network*, 637 A.2d 34, 41–42 (Del. 1994).

the offer altogether, rather than strictly adhering to potentially superficial criteria.²⁵⁷ Ohio directors may then make the best decision for the firm, but are not so free from shareholder accountability as to act in their self-interest to the detriment of the firm.

To be sure, under this model, courts are charged with evaluating whether directors have acted as “faithful negotiating agents” for shareholders in the takeover context.²⁵⁸ But these fiduciary duties are still very deferential, and simple criteria can be adopted to restrict potential fiduciary breaches.²⁵⁹ In situations where directors defeat a tender offer altogether, usually by adopting takeover defenses,²⁶⁰ directors may do so only if there is confidential information or a failed negotiation attempt to secure a higher price.²⁶¹ In the auction context, only an effort to induce a higher bid or differences between partial and any-and-all tender offers justify favoring one bidder over another.²⁶² A duty of care styled in this manner would strike an appropriate balance to grant discretion to directors making business decisions while still providing shareholders with a limited monitoring device.

While Ohio should adopt provisions to heighten the standard of care, flexible provisions should also be available to allow firms to elect to increase director discretion. One such provision would allow corporations to opt in to the heightened business judgment rule with a waiver of the duty of care for damages suits, similar to Delaware General Corporation Law section 102(b)(7). Currently, Ohio law has an opt out provision for the business judgment rule when damages are sought.²⁶³ Shareholder choice

²⁵⁷ Nonetheless, exceptions based upon confidential information should be limited. Oesterle, *supra* note 63, at 125–26 (“Even in a weak form, however, this argument provides only limited justification for target management responses, and may too easily conceal target manager selfishness. Arguments based on confidential information are always easy to make, and, unless investigated on a case-by-case basis, serve only to insulate target managers from accountability. Such a case-by-case evaluation would be costly and a broader rule disfavoring the arguments based on confidential information may prove the more prudent choice.”).

²⁵⁸ *Id.* at 131.

²⁵⁹ *Id.* But see Easterbrook & Fischel, *supra* note 18, at 1196 (questioning whether courts can feasibly follow criteria to enforce fiduciary duties).

²⁶⁰ Oesterle, *supra* note 55, at 64–70 (providing an overview of takeover defenses).

²⁶¹ *Id.*

²⁶² *Id.* at 94–95. Confidential information does not provide a basis for favoring one bidder over another in an auction. *Id.* at 93. “An any-and-all offer states that the bidder will buy any-or-all tendered shares of the target firm, as long as enough shares are tendered to insure control.” Oesterle, *supra* note 19, at 903 n.96.

²⁶³ OHIO REV. CODE ANN. § 1701.59(E) (West Supp. 2012) (“This division does not apply if, and only to the extent that, at the time of a director’s act or omission that is the subject of complaint, the articles or the regulations of the corporation

regarding the business judgment rule reduces agency costs with flexibility for shareholders to decide whether fiduciary duties, automatic blocking mechanisms and/or shareholder voting are the best director-monitoring device.²⁶⁴

Regarding the duty of loyalty, Ohio should consider a rule that finds directors inherently conflicted when plaintiffs bring an action for injunctive relief to stop director-negotiated transactions and in other self-dealing situations.²⁶⁵ In situations where agency costs are high due to potential self-dealing, interested managers should be forced to justify their decision or removed from the decision-making process.²⁶⁶ Contrary to Ohio Revised Code section 1701.60(C), this rule would place the burden on directors to show that they met a section 1701.60(A) provision: that the deal was fair,²⁶⁷ approved by disinterested directors or ratified by informed shareholders.²⁶⁸ These procedures do not place an unreasonable burden on directors in these situations and further promote the firm's best interests. Against this background, Ohio corporate law should be amended to effectively reinstate Ohio directors' duties of care and loyalty.

3. *Antitakeover Statutes*

Ohio antitakeover legislation is poorly drafted and implements extreme policy such that it harms the business climate it is designed to help. Ohio's six antitakeover statutes are considered extreme because they do not serve a coherent purpose; only Pennsylvania and Massachusetts rival Ohio in this

state by specific reference to this division that the provisions of this division do not apply to the corporation.").

²⁶⁴ Winter, *supra* note 30, at 259; see Kobayashi & Ribstein, *supra* note 18, at 1174; Ribstein, *supra* note 87, at 390-91.

²⁶⁵ Oesterle, *supra* note 55, at 86-87 (noting that directors should be considered inherently self-interested when instituting defenses against hostile tender offers). In hostile tender offer situations, directors carry the burden to justify their conduct, for example with a shareholder ratification vote. *Id.* Upon meeting this burden, plaintiffs carry a high burden to show director misconduct. *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.* at 87 ("The standard of fairness in tender offers, however, would take its conceptual cues solely from the reasonableness of the target managers' acts in light of their role as a negotiating agent for the shareholders.").

²⁶⁸ See, e.g., *Unitrin Inc., v. Am. Gen. Corp.*, 651 A.2d 1361, 1390 (Del. 1995) ("If the Court of Chancery concludes that individually and collectively the poison pill and the Repurchase Program were proportionate to the threat the Board believed American General posed, the Unitrin Board's adoption of the Repurchase Program and the poison pill is entitled to review under the traditional business judgment rule. The burden will then shift 'back to the plaintiffs who have the ultimate burden of persuasion [in a preliminary injunction proceeding] to show a breach of the director's fiduciary duties.' (quoting *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985)).

regard.²⁶⁹ Ohio's antitakeover statutes discourage incorporation in Ohio because they decrease shareholder wealth, raise the cost of capital to Ohio companies and serve as a market signal of poor organizational performance.²⁷⁰ There are negative effects on shareholder wealth because statutory protection from the market for corporate control perpetuates agency costs, thereby decreasing the takeover premium inherent in stock price.²⁷¹ And reincorporation in a jurisdiction with extreme takeover protection is an indicator of poor or inefficient management because the market may suspect that reincorporation is designed to protect management from deals that would replace management with more efficient leadership.²⁷² In practice, the proxy advisory firm ISS advised Abercrombie shareholders not to reincorporate in Ohio because it would shield management from competitive pressure to perform.²⁷³ This subsection will introduce Ohio takeover legislation in its historical context, discuss policy issues with the statutes and make recommendations for reforming Ohio antitakeover legislation.

i. Objectives for State Antitakeover Regulation

In addition to attracting charters and talented management in the race debate,²⁷⁴ state takeover legislation may be designed to discourage unwanted bidders from coercing shareholders into business combinations, but should not discourage friendly deals in which bidders negotiate deals

²⁶⁹ Several statutes constitute Ohio's legislative efforts to deter bidders for corporate control. OHIO REV. CODE ANN. § 1701.16(B) (West 2009) (authorizing firms to adopt poison pills); § 1701.59(F) (West Supp. 2012) (constituency statute); § 1701.831 (control share acquisition act); § 1704.01-.07 (business combinations); § 1707.041 (control bid); § 1707.043 (disgorgement); *see* Subramanian, *supra* note 1, at 1873 (noting that Pennsylvania, Massachusetts and Ohio have extreme antitakeover statutes).

²⁷⁰ Romano, *supra* note 37, at 856 n.46; Ryngaert & Netter, *supra* note 19, at 373.

²⁷¹ Easterbrook & Fischel, *supra* note 18, at 1164 ("The value of any stock can be understood as the sum of two components: the price that will prevail in the market if there is no successful offer (multiplied by the likelihood that there will be none) and the price that will be paid in a future tender offer (multiplied by the likelihood that some offer will succeed)."); *see also* OESTERLE, *supra* note 22, at 531-32 ("Higher takeover prices and the increased possibility of failure increase the potential cost of any potential takeover, discourage first bidders at the margin, and thereby deny some target-firm shareholders a significant potential increase in the value of their shares by discouraging bidders from putting their firms *in play*.").

²⁷² *See* discussion *supra* Part II.B; Edgar v. MITE Corp., 457 U.S. 624, 643-44 (1982) ("The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced." (citations omitted)).

²⁷³ ISS PROXY ADVISORY SERVS., *supra* note 14, at 4-5.

²⁷⁴ *See* discussion *supra* Part II.A.

with target management.²⁷⁵ Antitakeover statute proponents argue that collective action problems lead to shareholder coercion absent protection from unwanted bidders.²⁷⁶ A hostile takeover generally consists of the following two steps: first, a tender offer to obtain a toehold or majority control interest in the target firm; second, a proxy contest to obtain enough seats on the board of directors to effect a back-end merger.²⁷⁷ In these situations, it is argued, shareholders may be coerced into tendering their shares to the unwanted bidder because if they do not tender immediately, they will be squeezed-out later at a lower price. Exacerbating the shareholder collective action problem, bidders, who are often management, have an informational advantage over shareholders when short-lived tender offers are made on a first-come, first-served basis.²⁷⁸

Different antitakeover statutes address these shareholder coercion issues in different ways: for instance, some statutes are designed to give target shareholders the opportunity to gather information, collectively organize and weigh the desirability of the tender offer.²⁷⁹ Another example are business combination statutes that require board approval to effect a business combination, in effect driving bidders to negotiate with shareholders through one voice (the target board).²⁸⁰

Regarding shareholder coercion, antitakeover statutes should be considered in the context of firm-specific takeover defenses, including shark repellants,²⁸¹ poison pills, lock-ups and repurchase agreements.²⁸²

²⁷⁵ Oesterle, *supra* note 63, at 124–30 (discussing shareholder coercion problems in tender offers); *see, e.g.*, Oesterle, *supra* note 19, at 902, 906–08.

²⁷⁶ Oesterle, *supra* note 63, at 127–29; Oesterle, *supra* note 19, at 900–08.

²⁷⁷ Oesterle, *supra* note 19, at 894. Tender offers may be a two-tiered tender offer or an any-and-all tender offer. In the back-end merger, the remaining shareholders stock will be exchanged for other securities, such as preferred stock or debt. *Id.*; *see also* Unitrin Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1379 (Del. 1995) (stating that “commentators have characterized a return to proxy contests as ‘the only alternative to hostile takeovers to gain control against the will of the incumbent directors’” (citing Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1071, 1134 (1990))).

²⁷⁸ OESTERLE, *supra* note 22, at 161; *see, e.g.*, Oesterle, *supra* note 55, at 60–61 (providing hypothetical examples).

²⁷⁹ OESTERLE, *supra* note 22, at 168; *e.g.*, OHIO REV. CODE ANN. §§ 1701.831, 1707.043 (West 2009).

²⁸⁰ Oesterle, *supra* note 19, at 895 (“The drafters of the Delaware statute, by effecting a statutory prohibition on back-end mergers and all their economic equivalents, hoped to stop most bootstrap acquisitions that do not have the blessing of existing management.”).

²⁸¹ Shark repellent takeover defenses are charter provisions that require a specific shareholder vote. OESTERLE, *supra* note 22, at 512–13. Such provisions include staggered and classified boards of directors, written consent procedures for

When firm-specific takeover defenses and strategies are combined with state antitakeover statutes, it can be very difficult for unwanted bidders to gain control of a corporation and complete a business combination.²⁸³ Antitakeover statutes that ward-off unwanted bidders, instead driving bidders to negotiate with the target board, should be designed to address shareholder coercion that exploits collective action problems.²⁸⁴ Because alternatives to antitakeover legislation are available in the form of managers as negotiating agents and firm-specific takeover defenses, antitakeover statutes should be discretionary provisions that avoid the high costs of mandatory provisions.²⁸⁵ In sum, antitakeover legislation should be designed to put shareholders on equal footing with bidders.²⁸⁶

The goals of eliminating shareholder collective action problems and management's informational advantage are indeed noble at first blush, but these issues have been subject to considerable debate. There is conflicting evidence as to whether shareholders are actually coerced to tender their share to unwanted bidders. Presumably, two-tiered tender offers are more likely to result in shareholder coercion because those tender offers are more likely to be heavily front-end loaded than any-and-all tender offers.²⁸⁷ But an SEC study has found fewer shareholders tender for potentially coercive two-tier tender offers than any-and-all tender offers.²⁸⁸

Moreover, incidental consequences of antitakeover legislation can have a detrimental impact on wealth-generating transactions. Paramount in this respect is that neutralizing management's informational advantage increases the cost of tender offers and reduces the number of bids, as supported by empirical evidence.²⁸⁹ As a result of fewer tender offers,

shareholder voting without a meeting, and limiting the creation of new seats on the board of directors. *Id.*

²⁸² Oesterle, *supra* note 19, at 884–85.

²⁸³ *Id.*; Oesterle, *supra* note 55, at 64–65.

²⁸⁴ See Oesterle, *supra* note 19, at 900–02.

²⁸⁵ See Oesterle, *supra* note 63, at 126–30 (discussing shareholder coercion problems in tender offers); see, e.g., Oesterle, *supra* note 19, at 902, 906–08. But see Easterbrook & Fischel, *supra* note 18, at 1194–203 (explaining the passivity thesis).

²⁸⁶ See Oesterle, *supra* note 19, at 900–02.

²⁸⁷ Oesterle, *supra* note 63, at 130.

²⁸⁸ Robert Comment & Gregg A. Jarrell, *Two-Tier and Negotiated Tender Offers: The Imprisonment of the Free-riding Shareholder*, 19 J. FIN. ECON. 283, 304 (1987) (“The average premium for the 144 any-or-all offers, at 56.6% above the pre-offer market price, does not differ significantly from the average yield on the 39 two-tier offers of 55.9%”); see also Oesterle, *supra* note 19, at 902.

²⁸⁹ Gregg A. Jarrell & Michael Bradley, *The Economic Effects of Federal and State Regulation of Cash Tender Offers*, 23 J.L. & ECON. 371, 373 (1980) (stating that the number of tender offers made decreased and the cost of tender offers increased

managers may become entrenched because low stock price—indicating managerial inefficiency—may not attract a takeover bid as it otherwise might.²⁹⁰ Regarding fairness, management's informational advantage is equitable to shareholders because empirical evidence shows that target shareholders consistently capture more of the value created by transactions than do bidders.²⁹¹ In fact, disclosure during a transaction is inequitable among bidders because second bidders may free ride on the first bidder's disclosures to obtain a bidding advantage.²⁹²

But even if there is shareholder coercion and bidders' informational advantage could be neutralized, state antitakeover statutes should not be designed to discourage friendly and hostile business combinations alike—in effect discouraging *all* deals. Instead, antitakeover statutes should be designed to enable the target board to act as negotiating agents for shareholders to limit shareholder coercion with a collective voice.²⁹³ Friendly deals in which the target board acts as a negotiating agent on behalf of shareholders should be encouraged to increase shareholder wealth.²⁹⁴ Target boards provide needed flexibility to respond to tender offers and do so in a timely manner.²⁹⁵ By contrast, automatic blocking mechanisms may not provide the needed flexibility that negotiating agents provide.²⁹⁶ Critics of the active manager, who embrace the “passivity thesis,” charge that agency problems between management and shareholders limit board capacity to act as agents for shareholders.²⁹⁷ In any

following passage of the Williams Act). Furthermore, the number of tender offers did not return to pre-Act levels for eleven years. OESTERLE, *supra* note 22, at 169.

²⁹⁰ See discussion *supra* Part II.B.

²⁹¹ OESTERLE, *supra* note 22, at 25–26; Easterbrook & Fischel, *supra* note 18, at 1187.

²⁹² OESTERLE, *supra* note 22, at 168; Easterbrook & Fischel, *supra* note 18, at 1178; Subramanian, *supra* note 52, at 700–04 (discussing the “Revlon Problem” in the context of market efficiency).

²⁹³ See, e.g., Oesterle *supra* note 19, at 900–02, 906–08.

²⁹⁴ See generally Oesterle, *supra* note 55, at 64–73 (discussing boards of directors as agents negotiating on behalf of shareholders). But see generally Easterbrook & Fischel, *supra* note 18, at 1174–82.

²⁹⁵ See Oesterle, *supra* note 55, at 63. Fiduciary duty laws can provide for the proper target director role in negotiating transactions. *Id.* at 72–73.

²⁹⁶ See *id.* at 67.

²⁹⁷ Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN L. REV. 1, 1 (1982–83) (“In most cases resistance reflects either mismanagement (to the extent it pointlessly denies shareholders the opportunity to obtain a premium) or manager’s self-protection (to the extent its point is to preserve managers’ jobs or ‘sell’ their acquiescence in exchange for bonuses or promises of future employment).”). Easterbrook and Fischel also argue that auctioning the company will increase the price for corporate control, reducing the number of takeovers, and in turn reduce the market for corporate control as a check on inefficient management. *Id.* at 2. But see Oesterle, *supra* note 55, at 56, 73–81.

event, these passivity thesis scholars also embrace friendly deals.²⁹⁸ In other words, there does not appear to be a sound intellectual basis for discouraging all business combinations as Ohio does under its antitakeover legislation.²⁹⁹

Despite Ohio antitakeover proponents' arguments discouraging friendly deals,³⁰⁰ laws that restrict all deals are too confining.³⁰¹ This section will advocate Ohio antitakeover legislation that encourages bidders to negotiate with the target board to address shareholder coercion issues. In addition, antitakeover legislation should be clearly drafted, discretionary rather than mandatory (i.e. firms may opt out or opt in), and consistent with related statutes. Antitakeover legislation designed with these policy objectives attracts corporate charters and attracts talented management in the race debate, while also remedying any shareholder coercion issues.³⁰²

ii. *Ohio Antitakeover Legislation: Its Historical Context*

Ohio commenced corporate takeover regulation in 1969 with a first generation antitakeover statute—the Ohio Takeover Act, which is now

²⁹⁸ Easterbrook & Fischel, *supra* note 18, at 1174 (“The argument presented above establishes that takeovers are beneficial to both shareholders and society.”).

²⁹⁹ Even one shareholder primacy critic agrees that Ohio corporate law is extreme. Fisch, *supra* note 50, at 657.

³⁰⁰ See Shipman, *supra* note 197, at 527 (advocating antitakeover legislation aimed at friendly deals). But see Morgan Shipman, *Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act*, 21 CASE W. RES. L. REV. 722, 757 (1970). Further, a practitioner argues:

The real impact of the law, in my opinion, will be felt not so much in its application as in its hovering omnipresence. I suspect, so far as Ohio and Ohio-based corporations are concerned, the corporate takeover as a form of corporate warfare is a thing of the past. Acquisitions will hereafter be negotiated. If management is unresponsive to the desire of shareholders it will be removed by proxy contest carried on in the open rather than by the secretly organized surprise attack which has, up to now, characterized the takeover bid.

Arthur I. Vorys, *Ohio Tender Offers Bill*, 43 OHIO ST. B. ASS'N REP. 65, 73 (Jan. 19, 1970). Based upon this quotation, Mr. Vorys advocated antitakeover legislation aimed only at non-friendly deals.

³⁰¹ E.g., Harold Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35, 36–39 (1966) (discussing law on contracts between an officer and his corporation as of 1880).

³⁰² Subramanian, *supra* note 1, at 1861 (noting that extreme antitakeover legislation discouraging all deals may decrease shareholder wealth and does not attract corporate charters better than non-extreme antitakeover legislation); e.g., Oesterle, *supra* note 19, at 900–08 (noting that the Delaware business combination statute is purportedly designed to address shareholder coercion problems).

known as the Control Bid Statute.³⁰³ The prior year, in 1968, Congress enacted the Williams Act to regulate corporate takeovers at the federal level.³⁰⁴ The federal Williams Act requires that corporate bidders give target shareholders twenty days to respond to tender offers,³⁰⁵ provides for all shareholders to receive the same price for their shares,³⁰⁶ prohibits the bidder from making open-market purchases during the tender offer³⁰⁷ and provides for shareholder withdrawal rights.³⁰⁸ Expanding upon the Williams Act, the Ohio Takeover Act, as originally written, required bidders to disclose certain information, provided authority for the Ohio Division of Securities to suspend deals and provided a rarely-used hearing process to resolve non-compliance with the Takeover Act.³⁰⁹

In 1982, the U.S. Supreme Court, in *Edgar v. MITE Corp.*, struck down an Illinois law modeled upon the Ohio Takeover Act as unconstitutional.³¹⁰ The Illinois Act at issue in *MITE Corp.* was struck down under the dormant Commerce Clause doctrine for discriminating against interstate commerce due to its broad applicability to firms that were not incorporated in Illinois.³¹¹ The Court also considered whether the Williams Act preempted the Illinois Act, but only three Justices joined in faulting the Act on preemption grounds.³¹² Preemption issues arose due to the indefinite delay that might exceed the twenty-day waiting period prescribed under the Williams Act and the Illinois Secretary of State's discretion under the Act

³⁰³ OHIO REV. CODE ANN. § 1707.041 (West 2009); Ohio Takeover Act, No. 90, 1969 Ohio Laws 352 (revising section 1707.041 of the Ohio Revised Code); Shipman, *supra* note 300, at 723.

³⁰⁴ The Williams Act added sections 13(d)–(e) and 14(d)–(f) to the Securities Exchange Act of 1934. Senator Harrison Williams, the namesake and sponsor of the Williams Act, went to federal prison on bribery charges. OESTERLE, *supra* note 22, at 534.

³⁰⁵ 17 C.F.R. § 240.14e-1 (2011). For a more thorough explanation of the Williams Act's provisions, see OESTERLE, *supra* note 22, at 161–63.

³⁰⁶ The all-holders rule prohibits bidders from discriminating against shareholders holding shares of the type sought. 17 C.F.R. § 240.14d-10(a)(1). The best price rule requires bidders to extend price increases during the tender offer to all shareholders. *Id.* § 240.14d-10(a)(2).

³⁰⁷ *Id.* § 240.14e-5.

³⁰⁸ *Id.* § 240.14d-7(a). A withdrawal right gives a shareholder who has tendered her shares to a depository institution the right to have her shares returned before the closing. OESTERLE, *supra* note 22, at 162 n.155.

³⁰⁹ OHIO REV. CODE ANN. § 1707.041 (West 2009); *see also id.* § 1707.01(V). A Lexis-Nexis search of the “OH Department of Commerce; Division of Securities Decisions” database for the search term “1707.041” renders only forty-five decisions. The latest decision was issued in 2001 and all but seven decisions were issued prior to 1990.

³¹⁰ *Edgar v. MITE Corp.*, 457 U.S. 624, 643 (1982).

³¹¹ *Id.* at 643–46 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)).

³¹² *Id.* at 639 (plurality opinion).

to review tender offers for substantive fairness, rather than let shareholders exclusively decide whether to accept an offer.³¹³ The latter provision frustrated the federally determined balance between bidders and target shareholders.

Once the Illinois Takeover Act was struck down in *MITE Corp.*, states, including Ohio, enacted second generation antitakeover statutes that required target shareholder approval for business combinations. Like its experiment with first generation statutes,³¹⁴ Ohio was among the first states to enact its second generation antitakeover statute in 1982, which is called the Ohio Control Share Acquisition Act (CSAA).³¹⁵ While Ohio and many other states already required a supermajority target shareholder vote to approve mergers and sales of substantially all assets,³¹⁶ the CSAA requires a separate shareholder and director vote to approve tender offers (i.e. control share acquisitions), unless a firm has opted out with a charter provision or regulation (bylaw).³¹⁷

In the shareholder vote, as originally enacted, the CSAA disenfranchised shares held by management and the potential acquirer to address shareholder coercion issues.³¹⁸ Later amendments disenfranchised additional shares held by market arbitrageurs as well.³¹⁹ Today, the CSAA requires that within ten days of announcing the control share acquisition

³¹³ *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 80 (1987); *MITE Corp.*, 457 U.S. at 638–39 (plurality opinion).

³¹⁴ Shipman, *supra* note 300, at 771 (identifying the Ohio Takeover Act as “an interesting and useful experiment”).

³¹⁵ Ohio Control Share Acquisition Act, No. 258, 1982 Ohio Laws 4464 (amending certain provisions of Title XVII of the Ohio Revised Code); Shipman, *supra* note 197, at 516.

³¹⁶ OHIO REV. CODE ANN. § 1701.76 (West 2009) (asset sale); § 1701.78 (merger); *see also* Oesterle, *supra* note 55, at 65–66.

³¹⁷ § 1701.831(A) (providing that the CSAA is discretionary); § 1701.831(E)(1) (shareholder vote).

³¹⁸ Thomas E. Geyer, *The Vitality of the Ohio Laws Designed to Encourage Negotiated Takeovers*, 23 U. DAYTON L. REV. 515, 526–27 (1998) (“Functionally, the Control Share Acquisition Act sets out three requirements: (i) a potential acquirer must deliver to the issuing public corporation’s principal executive offices an “acquiring person statement” that sets forth certain minimum information about the acquirer and the proposed acquisition; (ii) within ten days after receipt of an acquiring person statement conforming to law, the issuing public corporation’s directors must call a special meeting of shareholders for the purpose of voting on the proposed control share acquisition (“831 meeting”); and (iii) special quorum and voting standards are imposed at the 831 meeting.”).

³¹⁹ As of this writing, the CSAA disenfranchises shares acquired within proximity to the shareholder vote. § 1701.01(CC)(1); Geyer, *supra* note 318, at 539–40 (explaining the 1997 amendments to the definition of “interested shares” as they pertain to the CSAA).

(i.e. tender offer) the target company must call a special meeting (an "831" meeting) and hold both a director and shareholder vote on the acquisition.³²⁰ Shares purchased after the announcement date of the acquisition ("interested shares") are not permitted to vote at the 831 meeting.³²¹ When the tender offer is announced, the CSAA also requires offerors to disclose certain information to the target company.³²²

Second generation antitakeover statutes like the CSAA faced constitutional challenges under the Commerce and Supremacy Clauses like the first generation statutes before them. In 1987, the U.S. Supreme Court, in *CTS Corp. v. Dynamics*, upheld a second-generation statute in Indiana similar to the Ohio CSAA.³²³ Read in tandem with *MITE Corp.*, *CTS Corp.* granted states significant leeway to enact takeover legislation without preempting the Williams Act.³²⁴ The U.S. Sixth Circuit Court of Appeals found the CSAA unconstitutional under the Supremacy Clause and the Williams Act in 1987,³²⁵ but later upheld the CSAA in 1988 following *CTS Corp.*³²⁶

Separate from its serious legal issues, the CSAA simply did not work because shareholders would approve deals to obtain the share-price

³²⁰ § 1701.831(C)(1), (E)(1).

³²¹ *Id.* §§ 1701.01(CC)(1), 1701.831(E)(1). It should be noted that the interested share provision, which is designed to disenfranchise an arbitrageur's voice in transactions and protect gains among long-term shareholders, is unnecessary and impracticable. Arguably, arbitrageurs will decrease target shareholder value in transactions because arbitrageurs have only a short-term interest in flipping the stock price, whereas long-term shareholders will want to obtain the full value of a corporation, including operational value. However, because initial long-term shareholders who sell to arbitrageurs do so at a fair market price and arbitrageurs want to make a profit, an arbitrageur's voice in transactions will not support a price less than the fair market value. Long-term shareholders have already "rung the cash register," so to speak. As a consequence, arbitrageurs do not have interests misaligned with long-term corporate interests and are very difficult to identify.

³²² *Id.* § 1701.831(B).

³²³ *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 88 (1987).

³²⁴ *See CTS Corp.*, 481 U.S. at 79-84 ("In our view, the possibility that the Indiana Act will delay some tender offers is insufficient to require a conclusion that the Williams Act pre-empts the Act. The longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly."); *Edgar v. MITE Corp.*, 457 U.S. 624, 638-39 (1982).

³²⁵ *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 744 (S.D. Ohio 1986), *aff'd*, 796 F.2d 135 (6th Cir. 1986), *vacated*, 481 U.S. 1026 (1987); *see also* Geyer, *supra* note 318, at 528.

³²⁶ *Veere Inc. v. Firestone Tire & Rubber Co.*, 685 F. Supp. 1027, 1031-33 (N.D. Ohio 1988); *see also* Geyer, *supra* note 318, at 529-30.

premium paid to target shareholders.³²⁷ Blaming the CSAA's failure on "market arbitrageurs," Ohio enacted amendments to the CSAA in 1990 designed to disenfranchise these arbitrageurs.³²⁸ The 1990 amendments to the CSAA disenfranchised "interested shares," as defined to include shares obtained within a specific period before the takeover bid announcement.³²⁹ These amendments led to potentially unreasonable delay in holding up deals because it was impracticable to timely identify owners of shares held under "street names," issues with defining the "record date" of the transaction, and issues with transferring shares separate from voting rights following the record date.³³⁰ Once again, federal courts were tasked to determine whether the Williams Act preempted Ohio takeover legislation, and once again, a federal court found the CSAA unconstitutional.³³¹ After the CSAA withstood a subsequent constitutional challenge in 1996,³³² the Ohio General Assembly addressed the CSAA's constitutional infirmities with additional legislation in 1997.³³³

³²⁷ Geyer, *supra* note 318, at 530 ("However, as the Control Share Acquisition Act was applied to control share acquisitions in the late 1980s, some practitioners believed that the Control Share Acquisition Act operated as a 'Trojan Horse' in that although the proposed control share acquisition went before a vote of the shareholders, the shareholders typically included market arbitrageurs who would most likely always vote in favor of the proposed transaction.").

³²⁸ Act effective Apr. 11, 1990, No. 180, 1990 Ohio Laws 1610, 1631 (amending provisions of the general corporation law); *see also* Geyer, *supra* note 318, at 530–31.

³²⁹ *United Dominion Indus. v. Commercial Intertech Corp.*, 943 F. Supp. 857, 860–61 (S.D. Ohio 1996) (citing OHIO REV. CODE ANN. § 1701.01(CC)(2) and the 1990 amendments).

³³⁰ *Id.* at 862 ("This is the third time this Court has been called upon to consider the constitutionality of § 1701.01(CC)(2).").

³³¹ *Luxottica Grp. S.P.A. v. U.S. Shoe Corp.*, 919 F. Supp. 1085, 1090–91 (S.D. Ohio 1995) ("The Court finds that it would be impossible to comply with § 1701.01(CC)(2) within the sixty day period for reinstituting withdrawal rights under the Williams Act and that compliance with this particular provision of the Ohio Control Share Acquisition Act would frustrate the Congressional purpose of preventing undue delay in the consummation of a tender offer."); *Danaher Corp. v. Acme-Cleveland Corp.*, No. C2-96-0247, slip op. (S.D. Ohio July 1, 1996) (dismissed because the firms reached an agreement to end the litigation).

³³² *United Dominion Indus.*, 943 F. Supp. at 873–74 ("Unlike *Luxottica*, the Court in the instant case is unable to find that the procedures necessary to determine the existence of the second quorum and the results of the second vote would require delay in the consummation of a tender offer well beyond the parameters set by the Williams Act.").

³³³ Act effective Nov. 21, 1997, No. 73, 1997 Ohio Laws 495, 554 (amending provisions of the general corporation law).

Ohio adopted its third generation antitakeover statute in 1990—the “merger moratorium” or “business combination” statute.³³⁴ Unless a firm affirmatively opts out,³³⁵ Ohio’s business combination statute requires board of director approval to engage in a transaction with a potential acquirer for three years following the purchase of an interest in the company representing more than 5% of the aggregate shareholder value of the firm or 10% of income earning power.³³⁶ Additional restrictions requiring a shareholder vote are present after the three-year period as well.³³⁷ Measured against Delaware law, the restrictions on subsequent transactions are comparatively strong.³³⁸ As a result, the business combination statute effectively requires bidders to negotiate with the target board.

Also in 1990, Ohio adopted its fourth generation antitakeover statute, which requires bidders to disgorge profits made as a result of failed takeover attempts from which they derive a profit.³³⁹ In these “greenmail” situations, target management uses shareholder assets to fend off bidders while protecting the target board’s jobs.³⁴⁰ While Ohio’s disgorgement statute is an extremely potent device to deter takeovers, it goes too far and potentially “shut[s] down the market for corporate control as a disciplining device” on management.³⁴¹

Ohio’s other antitakeover provisions are also relevant here as well because Ohio’s antitakeover regulation is extreme in the aggregate. As discussed *supra* Part IV.A.2, Ohio has a constituency statute that provides excessive management discretion, which shields management from competitive pressure and shareholder accountability, and ultimately discourages efficient firms and value-creating transactions. Again, the constituency statute should be repealed, since antitakeover statutes are designed to avoid shareholder coercion, and are not a proper regulatory

³³⁴ Act effective Apr. 11, 1990, No. 180, 1990 Ohio Laws 1610, 1634 (amending provisions of the general corporation law).

³³⁵ OHIO REV. CODE ANN. § 1704.06 (West 2009).

³³⁶ *Id.* §§ 1704.01(B)(2)(a)(iii), 1704.02.

³³⁷ *Id.* § 1704.03.

³³⁸ See DEL. CODE ANN. tit. 8, § 203 (2010); see also Davidoff, *supra* note 4. See generally Oesterle, *supra* note 19 (discussing section 203).

³³⁹ § 1707.043.

³⁴⁰ Edward A. Zelinsky, *Greenmail, Golden Parachutes, and the Internal Revenue Code: A Tax Policy Critique of Sections 280G, 4999, and 5881*, 35 VILL. L. REV. 131, 135–36 (1990) (“[G]reenmail may occur in other guises, such as by permitting raiders to acquire assets from the target corporation on favorable terms or by allowing payments to raiders by a third party (the ‘white knight’) cooperating with the management of the target corporation.”).

³⁴¹ Subramanian, *supra* note 1, at 1862.

vehicle to benefit non-shareholder constituencies.³⁴² Finally, Ohio adopted a statute authorizing firms to adopt poison pills with the 1986 reforms.³⁴³ This statute should be retained to provide shareholder-authorized takeover defenses. In some situations, shareholders may rationally delegate authority to management for takeover defenses, among other reasons, because information is not readily available and can be costly to gather, and it is difficult for shareholders to collectively act.³⁴⁴ Taken in the aggregate, Ohio's antitakeover statutes are extreme as their complicated history reflects.

As an initial matter, Ohio should repeal its disgorgement statute because it is the statute most heavily correlated with negative shareholder wealth and does not have a well-reasoned purpose.³⁴⁵ To the detriment of Ohio's business environment, as supported with empirical data, the disgorgement statute raises the cost of capital to Ohio businesses because markets identify Ohio firms as inefficient due to protectionist corporate law.³⁴⁶

Moreover, Ohio's disgorgement statute goes beyond what is required to encourage bidders to negotiate with management because it also deters friendly value-creating deals that should be encouraged and entrenches management from competitive pressure to run efficient firms. Even if the disgorgement statute did have a purpose supported by policy rationale, it is duplicative of a federal tax on 50% on greenmail proceeds, which Congress had enacted prior to the Ohio General Assembly enacting its disgorgement statute serving the same purpose.³⁴⁷ Also, the disgorgement statute has not

³⁴² Oesterle, *supra* note 19, at 906–08; *see* Chesapeake Corp. v. Shore, 771 A.2d 293, 328 (Del. Ch. 2000) (“[O]ne must remember that the substantive coercion rationale is not one advanced on behalf of employees or communities that might be adversely affected by a change of control. Rather, substantive coercion is a threat to stockholders who might sell at a depressed price.”).

³⁴³ § 1701.16(B); Act effective Nov. 22, 1986, No. 278, 1985–86 Ohio Laws 6107, 6118–19 (amending parts of the general corporation law).

³⁴⁴ Oesterle, *supra* note 55, at 64–72. There are some situations in which shareholders have a greater interest in voting on specific decisions. For example, in situations where management is “selling-out” for personal benefits, engaged in a management buyout or making major one-time changes in the firm where the costs of informing shareholders and collective action is cost-effective, shareholders have more of an interest in voting. OESTERLE, *supra* note 22, at 151–52; *see also* Easterbrook & Fishel *supra* note 63, at 1442–44; Kobayashi & Ribstein, *supra* note 18, at 1172–73; Lewis Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fishel*, 89 COLUM. L. REV. 1449, 1456–57 (1989).

³⁴⁵ Subramanian, *supra* note 1, at 1858, 1862–63.

³⁴⁶ *Id.*; *see, e.g.*, Abercrombie discussion *supra* Part I.

³⁴⁷ Zelinsky, *supra* note 340, at 166–170 (federal taxes on greenmail).

been shown to attract management more effectively than other antitakeover statutes.³⁴⁸ For these reasons, Ohio should repeal its disgorgement statute.

In addition to repealing the disgorgement statute, Ohio should consolidate the control bid statute, the CSAA and the business combination statute to move Ohio towards coherent and straightforward antitakeover regulation. Under this proposal, Ohio's business combination statute should be retained as a takeover defense that strongly encourages bidders to negotiate with the board of directors.³⁴⁹ Further grounded in policy rationale, Ohio's business combination statute may be an effective tool to attract quality management so long as it is not taken to the extreme.³⁵⁰

Ohio's business combination statute is stronger than comparative third generation antitakeover statutes, but if other statutes are repealed Ohio antitakeover legislation in the aggregate would not be extreme on the whole. Also, the business combination statute's complexity may be one instance where complex drafting is desirable to encourage potentially hostile bidders to negotiate with the board of directors.³⁵¹ Due to its complexity, acquirers may go first to the board of directors to avoid the burden of interpreting the statute.³⁵² By contrast, complexity in other provisions serves only as a transaction or operating cost. Complexity in the CSAA, for example, is not desirable because it imposes a transaction cost in friendly deals where acquirers already negotiate with the board of directors.³⁵³ Notably, discretion to opt out of the business combination statute, as Ohio currently provides,³⁵⁴ should be provided to avoid the high costs associated with an inflexible mandatory statute.

While the business combination statute should be retained, the CSAA and the control bid statute warrant considerable revision and potential repeal. The CSAA should be repealed because the business combination statute already drives bidders to negotiate with the target board. As noted above, when bidders cannot negotiate friendly deals with the target board, they generally make a tender offer followed by a proxy contest and back-

³⁴⁸ Subramanian, *supra* note 1, at 1838.

³⁴⁹ Geyer, *supra* note 318, at 552 ("Commentary suggests that the General Assembly enacted this 'merger moratorium statute' to deter hostile takeovers by limiting the bidder's ability to carry out a second stage clean-up merger after the initial tender offer, and to encourage those persons proposing to acquire control of an issuing public corporation to negotiate with the target corporation's board of directors.").

³⁵⁰ See Subramanian, *supra* note 1, at 1804-05.

³⁵¹ See Thomas Geyer, *An Overview of Ohio's Takeover Laws*, OHIO CORP. LAWS OUTLINE (Bailey Cavalieri LLC, Columbus, Ohio), Sept. 16, 2003, at 9.

³⁵² *Id.*

³⁵³ Shipman, *supra* note 197, at 517.

³⁵⁴ OHIO REV. CODE ANN. § 1704.06 (West 2009).

end merger.³⁵⁵ The CSAA is designed to make the first step, the tender offer, more difficult with a disinterested shareholder vote.³⁵⁶ The business combination statute addresses the second step because business combinations following a tender offer require board or shareholder approval.³⁵⁷ As the business combination statute effectively addresses the second step, i.e. the back-end merger or other transaction, bidders must negotiate with the target board or win a proxy contest to complete a business combination.

The CSAA is therefore superfluous and unnecessary because potential acquirers already must negotiate with the target board. CSAA supporters may argue that the statute is designed to effectively stop proxy contests, in which the potential acquirer can elect a friendly target board that will approve the transaction. The CSAA, however, does not function to stop a proxy contest because it presupposes that market arbitrageurs, target directors and other interested shareholders have a short-term perspective that is not in all shareholders' or other stakeholders' best interests, which again raises the stakeholder debate.³⁵⁸

Further, in the tender offer context, even if market arbitrageurs hold interested shares and do not care about the firm in the long-term, previous shareholders have already sold their shares at a market price based upon their long-term perspective. As a consequence, the shares are properly

³⁵⁵ Oesterle, *supra* note 19, at 894; *see, e.g.*, *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1379 (Del. 1995).

³⁵⁶ Geyer, *supra* note 318, at 524 ("The general purpose of the Control Share Acquisition Act is to ensure that those who hold shares in a corporation before a takeover bid is announced have a sufficient opportunity to both consider and vote upon the proposal.").

³⁵⁷ § 1704.02.

³⁵⁸ OESTERLE, *supra* note 22, at 540.

The subjective premise was the Court of Chancery's *sua sponte* determination that Unitrin's outside directors, who are also substantial stockholders, would not vote like other stockholders in a proxy contest, i.e. in their own best economic interests

The Court of Chancery's subjective determination that the *stockholder directors* of Unitrin would reject an "excellent offer," unless it compensated them for giving up the "prestige and perquisites" of directorship, appears to be subjective and without record support. It cannot be presumed

[S]tockholders are presumed to act in their own best economic interests when they vote in a proxy contest.

Id. (citations omitted). Admittedly, in *Unitrin*, the Delaware Supreme Court inconsistently noted that shareholders were not capable of deciding whether to accept a tender offer but were competent to decide a proxy contest on the merits. *Unitrin*, 651 A.2d at 1387; *Chesapeake Corp. v. Shore*, 771 A.2d 293, 325–29 (Del. Ch. 2000) (discussing the court's reasoning in *Unitrin*).

valued to reflect this long-term perspective and the CSAA is unnecessary to avoid shareholder coercion. In this way, notwithstanding arbitrageurs, the market for corporate control works to hold target management accountable to shareholders to run efficient companies in a competitive environment. To the extent there are director conflicts in takeovers, these issues should be addressed with fiduciary duties that require directors to act in shareholders' best interests.³⁵⁹ Separately, the disclosure requirements under the control bid statute and the CSAA should be consolidated in a manner that is complementary to disclosure requirements under the Williams Act.

4. *A Starting Point for Reform: The Revised Model Business Corporation Act*

One solution is the adoption of the RMBCA. Similarly adopting a model act, the Ohio General Assembly codified parts of the Revised Uniform Partnership Act (RUPA) in 1997.³⁶⁰ If adopted, the RMBCA may provide a legal environment that will attract investment with straightforward and neutral corporate law. Furthermore, the RMBCA is regularly updated, which will provide a basis for future legislative reform and reduce legislative reform costs.³⁶¹ Any departures from the RMBCA should be based upon deliberate policy decisions and drafted in a straightforward manner. Under this principle, the General Assembly may amend the RMBCA, for example, if it decides that antitakeover legislation should consist primarily of a stand-alone business combination statute. By contrast, confusing provisions that needlessly generate legal expenses should be avoided when more conventional statutes could implement the same policy decisions. Consequently, the CSAA and the Control Bid Statute may warrant repeal.

C. *Limited Liability Companies—Chapter 1705*

The Ohio LLC statute should be revised to provide needed flexibility to Ohio LLCs and provide a distinct alternative to Ohio LLPs. Ohio enacted its first LLC act in 1994.³⁶² In enacting their codes, Ohio and other states

³⁵⁹ Oesterle, *supra* note 63, at 131 ("Courts should therefore accept the task of evaluating whether target managers have acted as faithful negotiating agents whenever plans that empower target managers to act as negotiators are adopted or exercised.").

³⁶⁰ § 1776 *et seq.* See generally Jeanne M. Rickert, *Ohio's New Partnership Law*, 57 CLEV. ST. L. REV. 783 (2009). Although still important in many respects, partnership law is less significant in recent years with the popularity of LLCs as the entity of choice among many entrepreneurs.

³⁶¹ Carney, *supra* note 35, at 742–43.

³⁶² Act effective July 1, 1994, No. 103, 1994 Ohio Laws 634 (providing for the formation and governance of LLCs).

conceived of LLCs as resembling partnerships, as the IRS required at that time to obtain flow-through partnership taxation status.³⁶³ In 1997, the IRS adopted check-the-box regulations, which no longer required LLCs to adopt formalistic characteristics of a partnership to obtain flow-through taxation.³⁶⁴ In light of this development, many states revised their LLC statutes³⁶⁵ to shift from the partnership model to pursue some strategic advantages of a corporation, including capital lock-in and transferability of member interests.³⁶⁶ In creating its new LLC statute, Ohio maintained a partnership basis for some prominent provisions.³⁶⁷ As a result, Ohio LLCs are a questionable combination of corporate and partnership entity characteristics.

1. *Fiduciary Responsibility Under Ohio LLC Law*

The most notable issue with the Ohio LLC statute is that it does not permit extensive contractual modification to fiduciary duties, limiting

³⁶³ Robert Galloway, *Limited Liability Companies May Now Be Formed in Ohio*, 4 OHIO PROB. L.J. 137, 137–38 (1994).

³⁶⁴ Treas. Reg. § 301.7701-1 to -3 (2011); see also Catherine M. Rogers, *Business Organizations—Staying Afloat with a Hole in the Wyoming LLC Act: Default Rules in a Contractual LLC World*, 5 WYO. L. REV. 351, 361–62 (2005). Four characteristics identified as necessary for LLC status prior to the check-the-box regulations include: (1) continuity of life; (2) centralized management; (3) free transferability of interests; and (4) limited liability. *Id.* at 358.

³⁶⁵ See, e.g., Ohio Limited Liability Company Act, No. 102, 1999 Ohio Laws 3358 (amending sections in chapter 1705 of the Ohio Revised Code); see also Kevin Gluntz, *Are LLC's Now the Ohio Entity of Choice for Estate Planning Purposes?*, 10 OHIO PROB. L.J. 29, 30 (2000); Charles W. Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 BUS. LAW. 499, 501–02 (2001) (noting that many states shifted their LLC statutes from the partnership to the corporation model).

³⁶⁶ The wave of new state LLC laws following the check-the-box regulations suggests that certain partnership characteristics are widely considered to be undesirable, including provisions addressing transferability rights, withdrawal rights and dissolution rights. See John Dwight Ingram, *Limited Liability Companies*, 6 FLA. ST. U. BUS. L. REV. 1, 2 & n.10 (2007) (citing state statutes enacted following the check-the-box regulations). Contractual modification of fiduciary duties may be a desirable feature of LLC laws. Murdock, *supra* note 365, at 500, 535.

³⁶⁷ *Committee Comment to § 1705.281*, 2012 Leg., 129th Gen. Assemb. File No. 72 (Ohio 2012) (“The language of this section is based on the comparable provision of Ohio’s partnership law, section 1776.44.”); see also Jeanne Rickert, Randy Walters & Ashley Gullet, *BOOM! Ohio Business Law Gets an Upgrade*, OHIO LAW., July/Aug. 2012, at 22 (“Members’ duties are substantially the same as the duties of partners in a partnership.”).

flexibility.³⁶⁸ Like partnerships, Ohio requires LLC members and managers to have mandatory fiduciary duties beyond the implied covenant of good faith and fair dealing.³⁶⁹ These duties include the duty of care and the duty of loyalty. The duty of loyalty specifically prohibits member competition with the LLC.³⁷⁰ LLC operating agreements may provide provisions to amend these duties, but only if the modifications are not “manifestly unreasonable.”³⁷¹ While Ohio should require the duty of good faith and fair dealing, the mandatory duties of care and loyalty are troublesome.

The duty of care is problematic as it relates to both LLC managers and members. The duty of care for managers is troublesome because Ohio managers are held to a negligence (i.e. ordinarily prudent person) standard for fiduciary responsibility, as opposed to the more typical gross negligence

³⁶⁸ OHIO REV. CODE ANN. §§ 1705.081(B), 1705.281, 1705.282, 1705.29(B) (West Supp. 2012); see Elizabeth S. Miller, *Are the Courts Developing a Unique Theory of Limited Liability Companies or Simply Borrowing from Other Forms?*, 42 SUFFOLK U. L. REV. 617, 635–36 (2009); see, e.g., Larry A. DiMatteo, *Policing Ohio Limited Liability Companies Under Contract Law*, 46 AM. BUS. L.J. 279, 279 (2009) (stating that “Delaware amended its limited liability company (LLC) law to allow for the contractual elimination of fiduciary duties.”). But see Sandra K. Miller, *Fiduciary Duties in the LLC: Mandatory Core Duties to Protect the Interests of Others Beyond the Contracting Parties*, 46 AM. BUS. L.J. 243, 243, 263 (2009) (arguing for “a Theory of Mandatory Core Duties that recommends that LLC legislation retain a mandatory core of fiduciary duties that cannot be contractually eliminated.”). In contrast to Delaware law, Miller advocates for limited legislative restrictions on contractually modifying fiduciary duties. Compare §§ 1705.281, and 1705.282, and 1705.29, with DEL. CODE ANN. tit. 6, § 17-1101(c)–(d) (West 2010). Illinois has a fiduciary duty law for LLCs similar to Miller’s model. See Murdock, *supra* note 365, at 535.

³⁶⁹ §§ 1705.281–.282; Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) (“Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.” (citations omitted)); see also Rickert, *supra* note 360, at 791 (noting that Ohio partnership law provides for mandatory fiduciary duties).

³⁷⁰ § 1705.281(B)(3) (“To refrain from competing with the limited liability company in the conduct of the limited liability company’s business before the dissolution of the limited liability company.”).

³⁷¹ *Id.* § 1705.081(B).

standard.³⁷² The constituency provision that provides added protection for corporate directors under Ohio Revised Code section 1701.59(F) is not present under the LLC statute for LLC managers, leading to potential for litigation regarding Ohio LLCs.³⁷³ Similarly, the duty of care for members provides unnecessary potential for liability or the need to contractually modify LLC operating agreements to reduce potential for member liability.³⁷⁴ In addition, the mandatory duty of loyalty, specifically the duty not to compete, is problematic for small business owners who manage more than one business as an LLC, or in situations where investors come together for a specific investment opportunity but otherwise pursue other business ventures.³⁷⁵

A prominent case in Ohio LLC jurisprudence, *McConnell v. Hunt Sports*, demonstrates that LLC fiduciary duties are material to Ohio's business environment.³⁷⁶ In *McConnell*, uncertainty regarding fiduciary duties raised doubt as to whether a group of Ohio investors could raise capital to attract a major business interest—the Columbus Blue Jackets of the NHL.³⁷⁷ As explained *infra* Part V, the Ohio court in *McConnell* used potentially flawed reasoning to interpret the operating agreement, which enabled a group of investors to make a poor investment. That poor investment later led to a questionable public bailout with serious issues under the Ohio Constitution.³⁷⁸ Again, *McConnell* demonstrates that LLC

³⁷² *Id.* § 1705.29(C)(1).

³⁷³ *Id.* § 1705.29.

³⁷⁴ *Id.* § 1705.281(C).

³⁷⁵ Dale Oesterle, *Subcurrents in LLC Statutes: Limiting the Discretion of State Courts to Restructure the Internal Affairs of Small Business*, 66 U. Colo. L. Rev. 881, 896–97 (1995) (noting that participants in small corporations often divide their time among several corporations); Jason Sims, *Beware of Ohio LLCs: New Law Changes the Game for LLC Members*, WHAT'S THE BIG DEAL? BLOG (May 9, 2012), <http://www.thebigdealblog.com/whats-the-big-deal/whats-the-big-deal/2012/05/09/beware-ohio-llc>.

³⁷⁶ *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193, 1214–15 (Ohio Ct. App. 1999); see Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 104–05, 132 (2011) (noting that the quality of courts is more statistically significant as to firms' decision where to form an LLC).

³⁷⁷ See discussion *infra* Part IV.A.

³⁷⁸ See generally Dave Ebersole, *Democracy in Ohio: Ohio's Fiscal Constitution and the Unconstitutional Nationwide Arena Deal*, 40 HASTINGS CONST. L.Q. (forthcoming Dec. 2012). The Nationwide Arena deal violates restrictions in the Ohio Constitution on public investment in the private sector. *Id.* As part of the bailout, an LLC disclaiming its mandatory fiduciary duties under Ohio law was created in contravention to Ohio LLC law. See Operating Agreement of Columbus Arena Management LLC, Section 5.3(b) (on file with the author) (“Duties of Managers. The Members and the Company acknowledge and agree that each Manager serves to represent the interests of the Person entitled to designate such

fiduciary duties are material to Ohio's business environment. Further, the noted issues with Ohio LLCs could have a detrimental impact on Ohio's business environment.

2. *Contractually Modifying Fiduciary Duties in Ohio LLCs*

Despite mandatory LLC fiduciary duties, Ohio practitioners may be able to amend LLC operating agreements as desired in most situations.³⁷⁹ But in light of the issues with LLC fiduciary duties noted above, Ohio practitioners may need to modify fiduciary duties as a matter of course. If practitioners choose to use Ohio LLCs, these modifications will create unnecessary legal expense and are uncertain in effect.³⁸⁰ Litigation costs can be significant to small businesses, and may explain why the quality of the legal environment has been empirically shown to be a leading factor in jurisdictional competition for privately held LLCs.³⁸¹

Under a manifestly unreasonable standard, operating agreements will need to be very specific in curtailing fiduciary duties.³⁸² Moreover, the manifestly unreasonable standard provides judges with little guidance or criteria for enforcement, thereby inviting judges to interfere with business

Manager and will not owe any fiduciary or other duties to any other Member and is entitled to make decisions and take action solely on the basis of the interests of the Person entitled to designate such Manager.”). The Columbus Arena Management (CAM) operating agreement may comply with Ohio LLC law, however, if the effective date on May 4, 2012 followed the Blue Jackets bailout. Nonetheless, questions persist because the 2012 committee comments to section 1705.29 of the Ohio Revised Code state that changes to LLC fiduciary duties “clarify,” rather than substantively change, Ohio LLC law. OHIO REV. CODE ANN. § 1705.29 cmt. (West Supp. 2012). Moreover, local media reports in May 2012 raised transparency issues with CAM. *See, e.g.,* Lucas Sullivan, *O'Brien: Arena Dealings Must Be Public*, COLUMBUS DISPATCH, May 22, 2012, <http://www.dispatch.com/content/stories/local/2012/05/22/obrien-arena-dealings-must-be-public.html>.

³⁷⁹ *See* Kobayashi & Ribstein, *supra* note 376, at 104–05.

³⁸⁰ Some practitioners advise clients to create LLCs in other states because of Ohio law. *E.g.,* Sims, *supra* note 375; John E. Sullivan III & D. Bowen Loeffler, *Ohio LLCs After Florida's Olmstead Decision: Why Ohio LLCs Are No Good Anymore, How to Fix Them, and What to Do Until They Are Fixed*, 21 OHIO PROB. L.J. 66, 66 (2010) (advising practitioners to avoid Ohio LLCs largely due to debtor protection concerns addressed in H.B. 48, 129th Ohio G.A. (2011)).

³⁸¹ *See* Kobayashi & Ribstein, *supra* note 376, at 104, 129–30 (noting that court quality is an important factor in jurisdictional competition for LLCs); *see also* Henry Butler & Larry Ribstein, *Opting-Out of Fiduciary Duties: A Response to Anti-Contractarians*, 65 WASH. L. REV. 1, 54–55 (1990) (noting that fiduciary duties impose costs including litigation costs associated with court interpretation).

³⁸² Sims, *supra* note 375.

affairs.³⁸³ Supporters of the manifestly unreasonable standard argue that vague terms are commonplace in law and that courts will develop criteria, including whether a fiduciary waiver is clear and unambiguous, to carve-out its meaning.³⁸⁴ But courts may construe terms to be clear and unambiguous in situations where they are not, as was the case in *McConnell*.³⁸⁵ As a result, mandatory fiduciary duties under the manifestly unreasonable standard impose serious costs on Ohio LLCs.³⁸⁶

Advocates for mandatory fiduciary duties echo the arguments refuted *supra* in the corporation context. Supporting this position are related arguments that hark back to the constituency position in the stakeholder debate, which is predicated on unequal bargaining power and inefficient markets.³⁸⁷ Because LLCs generally appeal to closely-held firms,³⁸⁸ the stakeholder debate should focus on bargaining power issues in the LLC context.³⁸⁹

³⁸³ Oesterle, *supra* note 375, at 906–14 (discussing factors that affect judicial contractual interpretation).

³⁸⁴ Mark Loewenstein, *Fiduciary Duties and Unincorporated Business Entities: In Defense of the “Manifestly Unreasonable” Standard*, 41 TULSA L. REV. 411, 431–32 (2006).

³⁸⁵ See *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193, 1203, 1206 (Ohio Ct. App. 1999).

³⁸⁶ See Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 232–37 (2005) (identifying costs arising from fiduciary duties in non-corporate forms).

³⁸⁷ Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 IOWA J. CORP. L. 555, 564 n.45 (2012) (“Among other concerns, traditionalists argue that subjecting fiduciary duties to contractual waivers confuses basic legal doctrine; deifies efficiency at the expense of fairness, trust, and other social values; relies on an overly simplistic notion of the contractual bargaining process; overestimates the prescience of those drafting contracts; imposes costs on third parties who rely on or transact with alternative entities; undermines investor confidence and the broader economy; represents a radical shift in tradition, which may have unforeseen consequences; and will lead to the outright demise of fiduciary protection, as contractual waivers become standard and ubiquitous.”); see also Miller, *supra* note 367, at 263, 271.

³⁸⁸ Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1628 (2004) (“Within Delaware, courts have consistently refused to impute heightened fiduciary duties to LLCs because of the closely held nature of the LLC.”); Larry E. Ribstein & Bruce H. Kobayashi, *Choice of Form and Network Externalities*, 43 WM. & MARY L. REV. 79, 89 (2001) (“LLC statutes are better adapted than standard corporation statutes to closely held firms.”). But see Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 DEL. J. CORP. L. 465, 477 (2009).

³⁸⁹ One advocate for mandatory LLC fiduciary duties, Professor Loewenstein, also cites free market principles when arguing against LLC freedom to contract.

LLCs are based upon freedom to contract.³⁹⁰ With the ability to tailor business entities to a particular venture, LLCs provide flexibility to closely held firms with investors who may negotiate the operating agreement.³⁹¹ The relative insignificance of publicly traded alternative entities (e.g., publicly traded LLCs and LPs) in the alternative-entity markets reflects that the LLCs are generally a vehicle for closely held firms.³⁹² In the closely held context, investor collective action problems are not as great and bargaining power does not present an issue significant enough to place third party interests above the contracting parties (i.e. LLC members), or limit the LLC as an investment tool.

Active investors in an LLC may rationally decide to curtail fiduciary duties because fiduciary duties are unnecessary in some situations and impose costs on LLCs.³⁹³ Fiduciary duties as monitoring devices in the LLC may be unnecessary due to other mechanisms that provide investor protection, including member voting.³⁹⁴ In the closely held context, voting

Loewenstein argues that mandatory fiduciary duties are efficient because fiduciary duties enhance the market for corporate (business entity) control. Loewenstein, *supra* note 384, at 438–39. So the argument goes, without mandatory fiduciary duties, investors will cede power to management to ward off hostile takeovers, which in turn makes the market for corporate control less efficient. *Id.* But an LLC does not derive its efficiency primarily from the market like a corporation with dispersed shareholders. Instead, LLCs may use alternative monitoring devices to promote firm efficiency, such as voting. Ribstein, *supra* note 386, at 233. Again, voting is a practical monitoring device in the LLC context due to its often closely held nature. If active LLC investors wish to use markets to discipline LLC managers, they may provide provisions to compel distribution or termination, which gives management a strong incentive to maintain firm value. Larry Ribstein, *The Mystery of the Success of Delaware Law: The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 139–40 (2009) (“Provisions requiring termination and liquidation are common in venture capital and private equity funds.”).

³⁹⁰ E.g., DEL. CODE ANN. tit. 6, § 18-1101 (West 2010) (“It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”). Moreover, default rules provide for fiduciary duties even in jurisdictions that do not require them. Because the LLC does not generally derive its efficiency from the market for LLC control, the takeover market does not justify mandatory fiduciary duties.

³⁹¹ Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 550 (1997) (“Fiduciary waivers in unincorporated firms closely resemble the sort of ‘real’ contracts that anticontractarians have held out as models in the public corporation debate.”).

³⁹² See Manesh, *supra* note 387, at 572, 574 (noting that the eighty-five publicly traded alternative entities studied may not represent the thousands of Delaware alternative entities in existence). *But see* Manesh, *supra* note 388, at 514 (predicting the “ascendency of the noncorporate form”).

³⁹³ Ribstein, *supra* note 386, at 232–37; Ribstein, *supra* note 392, at 548–50.

³⁹⁴ See Ribstein, *supra* note 387, at 233.

can be a very useful device for investor control because active investors may aggregate and collect information without the prohibitive costs associated with voting among passive investors. LLCs may also adopt alternative monitoring devices for managers, including mandatory distributions, a limited life and mandatory liquidation and instituting managers as full-fledged owners.³⁹⁵ Fiduciary duty costs include both litigation expenses that may arise to interpret fiduciary duties and weakening extralegal incentives to refrain from opportunistic conduct.³⁹⁶ At least in some circumstances, investors are better off waiving fiduciary duties, and when fiduciary duties are waived in these situations, LLCs have a lower cost of capital than they otherwise might.

3. *Moving Towards a New Ohio LLC Statute*

While Ohio LLC fiduciary duties contravene the flexibility that is so important to the LLC form, Ohio LLC law does provide flexibility to provide LLCs with capital lock-in. Typical of corporations, capital lock-in is an attractive entity characteristic because it enables business associations to allocate capital for long-term planning.³⁹⁷ Indeed, Ohio amended its original LLC act to limit LLC member withdrawal rights under the default provisions and shield LLC members from creditors with debtor protection regarding their LLC interest.³⁹⁸

Other characteristics have been identified as important to state competition for LLCs, including the quality of the legal environment and the degree of uniformity among jurisdictions.³⁹⁹ Ohio should examine its degree of uniformity with other states regarding LLC provisions, including withdrawal and dissociation rights.⁴⁰⁰

In sum, the Ohio LLC statute should provide Ohio LLCs with flexibility that is attractive to investors.⁴⁰¹ But in pursuing desirable entity characteristics, LLCs should avoid some undesirable partnership

³⁹⁵ Manesh, *supra* note 387, at 565–66.

³⁹⁶ Ribstein, *supra* note 388, at 232–37.

³⁹⁷ Ribstein, *supra* note 389, at 138 (“[C]orporations have the unique characteristic of capital lock-in, or liquidation protection. This insulates corporate assets and, more importantly, managers’ power from the owners’ ability to force liquidation.”).

³⁹⁸ OHIO REV. CODE ANN. § 1705.16 (West 2009) (withdrawal rights); § 1705.19 (debtor protection).

³⁹⁹ Kobayashi & Ribstein, *supra* note 376, at 104–08.

⁴⁰⁰ LLC uniformity factors into the jurisdictional competition for LLCs, but some scholars have questioned whether adoption of RULLCA promotes uniformity with other states. *Id.* at 107–08.

⁴⁰¹ Oesterle, *supra* note 375, at 883–84 (identifying “hands-off” LLC statutes in states such as Delaware that seek flexibility for LLCs).

characteristics.⁴⁰² The LLP provides an appropriate vehicle if practitioners seek an entity with mandatory fiduciary duties, other partnership characteristics and limited liability.⁴⁰³

To implement these policies, the Ohio LLC statute should provide default rules with fiduciary duties, but allow modification to eliminate all fiduciary duties other than the implied covenant of good faith and fair dealing. Delaware and the Revised Uniform Limited Liability Company Act (RULLCA) embrace flexibility and freedom to contract. Specifically, they permit contractual modification to fiduciary duties so long as the implied covenant of good faith and fair dealing is preserved.⁴⁰⁴ Using RULLCA as a foundation, Ohio LLC law may be amended to implement deliberate policy in a straightforward manner.⁴⁰⁵ With added flexibility regarding fiduciary duties, Ohio LLC law is better positioned to facilitate investment in Ohio.

D. Securities Regulation—Chapter 1707

Ohio securities regulation should be revised to lessen the burden on in-state businesses with more clarity and predictability. Specifically, Ohio securities laws should reflect recent changes to federal securities regulation and clearly define key terms. State securities laws (i.e. blue sky laws) should be designed to avoid preempting or otherwise crowding out federal securities regulation.⁴⁰⁶ In support of this goal, the National Securities

⁴⁰² Murdock, *supra* note 365, at 501–02 (noting that many states shifted their LLC statutes from the partnership to the corporation model).

⁴⁰³ Oesterle, *supra* note 375, at 882 n.4 (“Limited partnerships, long in place, give limited liability to limited but not general partners. Using corporations as general partners effects full limited liability if the general is adequately capitalized, but the complicated paperwork required has to be correct Moreover, the limited partners cannot control the incorporated general partner without some risk.” (citations omitted)); *see, e.g.*, §§ 1782.19, 1782.241.

⁴⁰⁴ REVISED UNIF. LIMITED LTD. CO. ACT § 409 (2006); *see also* Stan Johnson, *Duties Under the Utah Revised Limited Liability Company Act: Analysis of a Statutory Conflict*, 2002 UTAH L. REV. 551, 569 (2002) (discussing freedom to contract under the Delaware Act).

⁴⁰⁵ *See* Murdock, *supra* note 365, at 570 (“There is something to be said for a moratorium on the constant tinkering or, in some cases, complete overhaul that is going on with LLC statutes.”); *see id.* at 500 (stating that a uniform act for LLCs is desirable to create continuity among states that was lost with the adoption of the check-the-box regulations).

⁴⁰⁶ State securities regulation reform should coordinate with federal securities regulation to avoid overburdensome regulation, especially in areas where federal regulation is minimal such as private placements. *See* JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 240–42 (6th ed. 2009) (noting that state blue sky laws can be burdensome to issuers raising capital, but also citing

Improvement Act requires that states avoid preempting federal securities registration requirements.⁴⁰⁷ Indeed, Ohio law contains a “qualification by coordination” provision to provide that satisfaction of federal registration requirements dually satisfies state requirements.⁴⁰⁸

However, Ohio securities law is still overreaching in other areas because it does not fit well with federal laws. State antitakeover statutes, for example, crowd federal regulation under the Williams Act.⁴⁰⁹ Moving forward, state regulation should coordinate with federal regulation with a focus on areas that federal law does not regulate.

In addition to coordination with federal law, Ohio law could provide more clarity regarding key terms in securities regulation. The definition of “security,”⁴¹⁰ for example, is so ambiguous that it could be interpreted to regulate mortgages.⁴¹¹ But policy rationale suggests that mortgages are outside the scope of state securities regulation due to other regulatory bodies. In addition, Ohio should amend chapter 1707 to define “materiality” and provide certainty to businesses making disclosures. With a clear and predictable scope of materiality, Ohio businesses may avoid costs resulting from unnecessarily excessive disclosure and legal liability.⁴¹² Although whole-scale revision of Ohio’s securities laws is not necessary and the Uniform Securities Act (USA) is somewhat dated, the USA may serve as a reference point for the appropriate scope of regulation and clarity in legislative drafting.⁴¹³

V. OBJECTIONS TO TITLE XVII REFORM

The debate over Title XVII reform may more appropriately be one of degree, rather than one of absolutes. That is, surely *some* revision to Title

the Coordinated Equity Review program and the National Securities Markets Improvement Act as efforts to provide uniformity among jurisdictions).

⁴⁰⁷ National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3417 (codified as amended in scattered sections of 15 U.S.C.).

⁴⁰⁸ § 1707.09.

⁴⁰⁹ See discussion *supra* Part IV.A.3.

⁴¹⁰ § 1707.01(B).

⁴¹¹ See *id.* (including “title” within the definition of a “security,” which could be construed to include an interest in real estate).

⁴¹² Dale Oesterle, *The Overused and Under-defined Notion of “Material” in Securities Law*, 14 U. PA. J. BUS. L. 167, 169 (2011) (“[This] paper concludes with an argument for explicit exceptions, common in the stock exchange listings of other countries as well as our own.”).

⁴¹³ The Uniform Securities Act of 2002 has been adopted in Missouri, Oklahoma, Idaho, South Dakota, Iowa, Kansas, the US Virgin Islands, South Carolina, Maine, Vermont, Minnesota, Hawaii and Indiana. STATE OF WIS. DEP’T OF FIN. INSTS., *A Brief History of Securities Regulation*, <http://www.wdfr.org/fi/securities/regexemp/history.htm> (last visited Oct. 30, 2012).

XVII is warranted. Nonetheless, objections that challenge conventional wisdom support maintaining Title XVII as written. Namely, separate arguments opposing Title XVII reform assert the following two things: (1) Delaware corporate law is less certain than Ohio law; and (2) some business laws do not matter.

A. *Certainty Under Ohio and Delaware Law*

Ohio law advocates assert that Title XVII as written is necessary to maintain certainty to businesses under Ohio's largely statutory corporate law.⁴¹⁴ As the argument goes, Delaware's common law system of corporate law does not provide businesses with certainty, but rather subjects businesses to the "whim" of a court.⁴¹⁵ However, leaving fact-specific legal standards (i.e. fiduciary duties) to codified law is inherently problematic and leads to extreme policy positions. Moreover, the advantages of Ohio corporate law are unclear because Delaware is widely considered to provide certainty in corporate governance, Ohio corporate law is subject to interpretation by Ohio courts and policy decisions that should be debated are implicit in Ohio's supposedly certain law.

First, Delaware's common law system of corporate law provides businesses with certainty. In fact, the market for corporate law supports this position—Delaware incorporates 59% of all Fortune 500 companies and more than half of all U.S. corporations.⁴¹⁶ Expedient courts, predicable case law, expert judges, *inter alia*, provide businesses with certainty of the law.⁴¹⁷

Moreover, it is not clear that a civil system of law is more favorable than common law. Common law provides incremental evolution of the law that does not support populist overreaction to current events. For example, the last two economic downturns in the United States have resulted in sweeping financial reform providing burdensome regulations—namely the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Similarly, in Ohio, the CSAA was adopted following a corporate threat to relocate and a case in another jurisdiction holding directors liable for breaching fiduciary duties. Delaware common law, by contrast, benefits the state with

⁴¹⁴ Kevin Kinross, *O-H-Inc.?*, ACREDULA (Bricker & Eckler, Columbus, Ohio), Mar. 2, 2011, at 2.

⁴¹⁵ Feran, *supra* note 10 ("In Delaware, it's left up to a court, on what whim the Delaware courts are on." (quoting John Beavers)); *see also* John Beavers, *Why It's Important to Have Certainty About Directors' Protections*, LEXOLOGY (Mar. 15, 2011), <http://www.lexology.com/library/detail.aspx?g=a79dea16-c986-4be8-992d-d4eedc2353ba>.

⁴¹⁶ Bebhuk & Cohen, *supra* note 1, at 389.

⁴¹⁷ *See discussion supra* Part III.B.

incremental change from expert judges with no jury trials, which is especially appropriate with complex corporate law.

Critics argue that common law suffers from pitfalls that are not present under a civil system. As case law is fact specific, there is an opportunity for courts to avoid ruling on issues under the facts of a particular case.⁴¹⁸ Moreover, case law may be difficult to alter if certain facts do not arise in a case that goes to trial. Nonetheless, common law has proven effective for state corporate law, which often addresses fact-specific inquiries.

Second, it is not clear that Ohio courts apply Ohio law more predictably than Delaware courts apply Delaware law, or contemplate the consequences of their decisions on businesses. *McConnell v. Hunt Sports*, for example, interpreted an LLC agreement in a questionable manner.⁴¹⁹ In *McConnell*, members of an LLC bidding for the Columbus Blue Jackets franchise broke apart from the original entity and formed a new group that eventually won the franchise.⁴²⁰ At issue was whether the new group owed a fiduciary duty to the original LLC. The court interpreted the following clause in the LLC agreement to allow members of the original LLC to compete, essentially with themselves, for the franchise:

Members May Compete. Members shall not in any way be prohibited from or restricted in engaging or owning an interest in any *other* business venture of any nature, including any venture which might be competitive with the business of the Company.⁴²¹

The court held that its interpretation of the agreement was “clear and unambiguous.”⁴²² It is reasonable, however, to interpret the clause as allowing competition only in the general course of business, not in the

⁴¹⁸ See, e.g., Beavers, *supra* note 415.

⁴¹⁹ *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193 (Ohio Ct. App. 1999). As a matter of fiduciary responsibility, *McConnell* held that LLC fiduciary duties may be contractually limited. *Id.* at 1214–15.

⁴²⁰ *Id.* at 1201–02.

⁴²¹ *Id.* at 1206–07, 1215 (emphasis added). The court stated that:

The operating agreement constitutes the undertaking of the parties herein. In becoming members of CHL, appellant and appellees agreed to abide by the terms of the operating agreement, and such agreement specifically allowed competition with the company by its members. As such, the duties created pursuant to such undertaking did not include a duty not to compete. Therefore, there was no duty on the part of appellees to refrain from subjecting appellant to the injury complained of herein.

Id. at 1215.

⁴²² *Id.* at 1203, 1206.

course of franchise negotiations that “take away [the LLC’s] only purpose.”⁴²³ Moreover, if the contract were not read as clear and unambiguous, extrinsic evidence of the parties’ intent would have been admissible and the outcome of the case may have been different.⁴²⁴ To be sure, under the facts in *McConnell*, the original LLC was not likely to continue bidding against the new entity, but the court did not rest on that ground.⁴²⁵ Also, this consideration should not change the legal analysis within the four corners of the “clear and unambiguous” contract.⁴²⁶ Ohio statutes and courts therefore do not necessarily provide businesses with certainty and predictability, especially as compared to those of Delaware.

Because Ohio courts are not more reliable than Delaware courts, the manifestly unreasonable standard for modifying fiduciary duties in Ohio LLCs is particularly troublesome.⁴²⁷ By contrast, other states provide businesses with certainty by allowing very liberal contractual modification of LLC fiduciary duties.⁴²⁸ As the quality of the legal environment has been identified as an important factor in attracting LLC filings and corporate charters, fiduciary duties are material to state interests in fostering business activity.⁴²⁹ Thus, Ohio courts’ interpretation of largely codified Ohio corporate law cannot justify Ohio corporate law’s extreme and complex nature.

Third, implicit in certainty under current Ohio law is *extreme* policy. Corporate law’s fact-specific nature, including inquiries into fiduciary responsibility, makes it very difficult to codify nuanced corporate law. In an attempt to provide clarity, the Ohio General Assembly has even codified corporate law legislative history.⁴³⁰ But the result has been Ohio corporate law that reflects extreme policy positions. That is, any certainty provided to management by fiduciary duties under codified Ohio corporate law is a result of very little accountability to shareholders.⁴³¹ For example, Ohio’s six antitakeover provisions provide certainty inasmuch as they delay or

⁴²³ *Id.* at 1205.

⁴²⁴ *Id.* at 1206.

⁴²⁵ *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193, 1215–16 (Ohio Ct. App. 1999) (“Given the above, we conclude as a matter of law that it was not a breach of fiduciary duty for appellees to form, [sic] COLHOC and obtain an NHL franchise to the exclusion of CHL.”).

⁴²⁶ *Id.* at 1203, 1206.

⁴²⁷ See, e.g., *id.* at 1206, 1216; see OHIO REV. CODE ANN. § 1705.281 (West Supp. 2012); discussion *supra* Part IV.B. See generally DiMatteo, *supra* note 368 (surveying different state laws on the contractual modification of fiduciary duties).

⁴²⁸ See discussion *supra* Part III.B.

⁴²⁹ Kobayashi & Ribstein, *supra* note 376, at 129, 136. See generally Black, *supra* note 132.

⁴³⁰ E.g., § 1701.832.

⁴³¹ See discussion *supra* Part III.A.2.

prevent corporate takeovers, but at the expense of unnecessary complexity and extreme provisions.⁴³²

Even if the extreme policy underlying any certainty provided under Ohio law were desirable to corporations, default rules that require corporations to opt out of extreme provisions may not be appropriate. Rather, it may be appropriate to have optional rules that Ohio corporations may select as they desire. For example, Ohio's heightened business judgment rule in damages actions could be amended away from an opt out rule⁴³³ to an opt in election. In a similar vein, Delaware corporations may elect a heightened business judgment rule for damages actions under section 102(b)(7) of the Delaware General Corporation Law. For the forgoing reasons, it is not clear that Ohio corporate statutes provide certainty and revisions to Ohio corporate law should be publicly debated. Moreover, Title XVII reform stands to benefit Ohio public policy.

B. Law Matters

Corporate law matters to businesses in the United States.⁴³⁴ In the United States, Delaware has not only established itself as a leader in incorporation choice,⁴³⁵ but Delaware firms also exhibit greater stock value.⁴³⁶ Despite some conflicting evidence, a leading study found that IPO firms incorporating in Delaware are valued about 2% higher than firms that incorporate in other states.⁴³⁷ By contrast, stock price in Ohio firms declined 2% upon implementing Ohio's 1986 corporate law reform.⁴³⁸

⁴³² See discussion *supra* Part III.A.3.

⁴³³ § 1701.59(E).

⁴³⁴ Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 850 (2005) ("To students of corporate law, the proposition that corporate governance arrangements matter requires little explanation. As the evidence indicates, the quality of governance arrangements affects firm performance and shareholder value."); Jens Dammann & Mattias Schündeln, *The Incorporation Choices of Privately Held Corporations*, 27 J.L. ECON. & ORG. 79, 107 (2011); Dent, *supra* note 48, at 141 n. 207, 147 nn.232–35 (citing studies to show that investors are attracted to firms with good governance mechanisms and that institutional investors promoted good governance practices); see also Coffee, *supra* note 92, at 644 (referring generally to securities regulation and corporate law).

⁴³⁵ See discussion *supra* Part III.B.

⁴³⁶ Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 532–33 (2001); see also Subramanian, *supra* note 1, at 1795. But see Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004); Bebchuk, Cohen & Ferrell, *supra* note 144, at 1784–96 (refuting the Delaware effect).

⁴³⁷ Bebchuk, Cohen & Ferrell, *supra* note 144, at 1787–812.

⁴³⁸ Daines, *supra* note 436, at 525.

These shareholder wealth effects suggest that state corporate law is material.⁴³⁹

Securities regulation also matters. Internationally, the size of equity markets varies in similarly situated countries.⁴⁴⁰ While the United States is a leader among equity markets, its prominence has been challenged in recent years due at least in part to legal changes in federal securities regulation, including Sarbanes-Oxley and Dodd-Frank.⁴⁴¹ Therefore, legal rules do have a material effect on a jurisdiction's business climate.

Nonetheless, some still question whether corporate law is important.⁴⁴² First, Professor Coffee argues that the umbrella of federal securities regulation in the United States effectively serves the purpose of corporate law in many respects.⁴⁴³ A major purpose for corporate law is to strike a balance between management and shareholder power to decide corporate matters.⁴⁴⁴ In striking this balance, corporate law addresses the agency problem that exists among divergent shareholder and management interests and the collective action problem among diffuse shareholders. However, it may be asserted that securities regulation and exchange listing requirements sufficiently address these problems by requiring disclosure of fiduciary

⁴³⁹ As a corollary, there is conflicting evidence that corporate governance structures, whether privately implemented or by state law default, affects firm performance. Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 907–16 (2007). However, conflicting evidence may result because some corporate governance arrangements are material to firm performance while others are not. See Lucian Arye Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?* (Harvard Law Sch., John M. Olin Ctr., Discussion Paper No. 491, 2004), available at <http://ssrn.com/abstract=593423>.

⁴⁴⁰ Coffee, *supra* note 92, at 643–44.

⁴⁴¹ Due to the recent economic decline in the United States, U.S. IPOs severely declined in 2008 and have increased only marginally in recent years. Clyde Stoltzenberg et al., *The Past Decade of Regulatory Change in the U.S. and EU Capital Market Regimes: An Evolution from National Interests Toward International Harmonization with Emerging G-20 Leadership*, 29 BERKELEY J. INT'L L. 577, 588, 625 (2011). China has emerged as a global leader in IPOs. *Id.* at 625.

⁴⁴² Schrag, Lautzenhiser & Flahive, *supra* note 199, at 31–37 (noting that, even after the 1986 amendments to Ohio corporate law, Ohio directors still face potential liability under other state and federal laws, including securities laws).

⁴⁴³ Coffee, *supra* note 92, at 652, 704 (stating that relative uniformity in the federal law applicable to securities markets will overshadow local corporate law). Professor Coffee also argues that the critical restraints that most limit agency costs are contained in federal securities laws rather than state corporate law. *Id.* at 699; see also Schrag, Lautzenhiser & Flahive, *supra* note 199, at 31–37.

⁴⁴⁴ OESTERLE, *supra* note 22, at 32; Coffee, *supra* note 92, at 647 (stating that one theory posits “that shareholder dispersion depends on the ability of the legal system to protect minority shareholders”); see also Kahan & Kamar, *supra* note 88, at 739.

misconduct and providing remedies.⁴⁴⁵ For example, financial reporting requirements provide shareholders with transparency in corporate affairs and hold management accountable for their actions.

But if securities regulation sufficiently addresses agency problems, it is not clear why shareholder wealth effects are associated with incorporation choice. Admittedly, the Delaware effect could represent the superior and expeditious service provided by Delaware Court and the Delaware Secretary of State's office.⁴⁴⁶ A more likely explanation, however, is that securities regulation does not sufficiently address shareholders' interests in corporate governance in many instances, including fundamental corporate changes in control. For example, management is not required to immediately disclose merger negotiations under the securities laws.⁴⁴⁷ Federal takeover regulation has been marginally successful at best.⁴⁴⁸ As such, securities laws may not satisfy shareholders' interests in negotiating a business combination, which are more aptly protected through fiduciary responsibility under corporate law.

To be sure, the line between corporate law and securities regulation is indeed fuzzy.⁴⁴⁹ For example, U.S. securities laws regulate tender offers and proxy access, which materially affects corporate governance.⁴⁵⁰ Nonetheless, federal securities regulation in the United States does not sufficiently fulfill state corporate law's purpose.

Second, and related to the race debate, law may not matter if jurisdictions will ultimately converge upon the optimal legal rules regarding corporate governance and securities regulation. Indeed, one study has found that state corporate law has been uniformly adopted by 74% of states.⁴⁵¹ However, state corporate law is not uniform in material respects, including fiduciary responsibilities.⁴⁵² By contrast, a federal umbrella of securities laws has established significant uniformity in securities regulation, although state blue sky laws do differ in some respects. One explanation for differences in uniformity among corporate law and securities regulation is so-called "network externalities."⁴⁵³ Network externalities refer to the

⁴⁴⁵ Coffee, *supra* note 92, at 652, 699, 704.

⁴⁴⁶ See discussion *supra* Part III.B.

⁴⁴⁷ Basic, Inc. v. Levinson, 485 U.S. 224, 239 (1988).

⁴⁴⁸ Steven M. Davidoff, *The SEC and the Failure of Federal Takeover Regulation*, 34 FLA. ST. U. L. REV. 211, 247 (2007).

⁴⁴⁹ Coffee, *supra* note 92, at 669.

⁴⁵⁰ *Id.* at 683–91.

⁴⁵¹ Carney, *supra* note 35, at 731.

⁴⁵² For example, some states, including Delaware, have adopted shareholder primacy principles, whereas other states, including Ohio, attempt to hold management accountable to several constituencies. See discussion *supra* Part III.A.2.

⁴⁵³ Coffee, *supra* note 92, at 692.

phenomenon where a listing in equity markets becomes more valuable as more users come to the market.⁴⁵⁴ With more users, the market is more liquid and predictable, and price spreads narrow.⁴⁵⁵ Thus, securities markets benefit from these network externalities and, as a result, securities regulation is fairly uniform.⁴⁵⁶ Corporate law, by contrast, does not provide as significant externalities.⁴⁵⁷ To be sure, network benefits are present in corporate law inasmuch as the high volume of Delaware corporations provides a greater body of case law to develop corporate law.⁴⁵⁸ Notwithstanding this benefit, the network benefits in the securities context are likely stronger.

Other explanations address non-convergence among state corporate law as well. As noted above, the strength of interest groups in a jurisdiction, including local attorneys and corporate management, may affect political outcomes.⁴⁵⁹ Also, corporate law debates may reach different outcomes about the optimal state of the law because corporate law is often context specific.⁴⁶⁰ The type of corporation in a jurisdiction may affect the nature of its corporate law.⁴⁶¹ Closely held corporations may not require the protection of corporate law against agency problems because either the same people constitute management and ownership, or a controlling shareholder block directly monitors management.⁴⁶² Thus, shareholder protection may rationally be less protective in a jurisdiction that does not

⁴⁵⁴ *Id.* at 693.

⁴⁵⁵ *Id.*

⁴⁵⁶ *Id.* at 691.

⁴⁵⁷ See discussion *supra* Part III.C. But see Bebachuk & Hamdani, *supra* note 32, at 586–87.

⁴⁵⁸ Bebachuk & Hamdani, *supra* note 32, at 586–87. Also, uniform corporate law may decrease the cost of legal services by loosening the grip of local attorneys over such services. *Id.* at 587; see also Carney, *supra* note 35, at 721.

⁴⁵⁹ See discussion *supra* Part II.B.

⁴⁶⁰ Coffee, *supra* note 92, at 659–60.

⁴⁶¹ E.g., Kobayashi & Ribstein, *supra* note 18, at 1178 (discussing Nevada's attractiveness as an incorporation choice due to the types of Nevada firms); Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J. L. & BUS. 641, 646 (2011) ("I argue that cross-country differences in corporate ownership structure play a decisive role in determining why movements against the prevailing powers in corporate governance took different shapes, given the impact that the existence of large ownership blocks has on the relationship between different groups of shareholders, and between shareholders and stakeholders.").

⁴⁶² Dammann & Schündeln, *supra* note 434, at 81. Closely held corporations are more likely to have a controlling block of shareholders than a publicly traded company because publicly traded corporations are more liquid due to the equity markets. *Id.* Corporate law may be necessary to protect minority shareholders from the controlling block even if there is no significant agency problem among shareholders and management. *Id.* at 90.

have many publicly traded companies.⁴⁶³ Convergence among states in some respects therefore does not dismiss corporate law as immaterial.

Third, it may be argued that state corporate law does not matter because firms will contract around state default rules to write corporate charters with preferred corporate governance rules.⁴⁶⁴ The relevant data, however, indicates that firms are heavily influenced by corporate law default rules.⁴⁶⁵ Moreover, it is not clear that firms can effectively contract around some mandatory state rules.⁴⁶⁶ Bargaining among shareholders and management interests therefore does not trivialize corporate law. Thus, despite arguments asserting certainty under current Ohio corporate law and trivializing corporate law, Ohio should reform its corporate law and securities regulation to facilitate investment in Ohio.

VI. CONCLUSION

Against this backdrop of state corporate law that materially affects shareholder wealth, there is room and reason for Ohio to compete for corporate charters and improve its business climate. Somewhat curiously, the evidence is strong that most states do not actively compete for corporate law. In Ohio, for example, complex and extremely pro-management corporate law is not as competitive as Delaware's more neutral laws. Delaware law is neutral in that it takes shareholder interests into account in a way that non-competitive states do not because it recognizes that shareholders, in addition to management, influence corporate decisions and incorporation choice.⁴⁶⁷ Yet most states do not adopt neutral law or consistently update corporate law to compete for corporate charters.

States' non-competitive stance for corporate law may be rational regarding out-of-state firms. Actively competing with Delaware for out-of-state incorporations may be very difficult and require investment that is difficult during the current economic crisis. Nonetheless, this explanation

⁴⁶³ See *id.* at 80–81.

⁴⁶⁴ Bernard S. Black, *Is Corporate Law Trivial? A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 544 (1990).

⁴⁶⁵ Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Examination* 40 (John M. Olin Ctr. for Studies in Law, Econ. & Pub. Policy, Research Paper No. 335, 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=924578.

⁴⁶⁶ See *id.* at 10.

⁴⁶⁷ Kahan & Kamar, *supra* note 88, at 739–41. For example, Delaware showed consideration for shareholder interests by adopting a pro-management antitakeover statute only after a plurality of non-competitive states had done so. *Id.* at 740. Management's interests became so strong nationally that Delaware was essentially forced to adopt the antitakeover statute to remain competitive, even if it antagonized shareholders. *Id.*

does not preclude states from competing to incorporate in-state firms. There is a home-state bias for incorporations that makes competition for in-state firms plausible. Moreover, there is only a nominal cost to writing corporate law that is straightforward and efficient.

To enable Ohio to actively compete to charter firms located in Ohio, Ohio corporate law should be revised to strike a better balance between management and shareholders' interests. While corporate law should maintain deference to management, Ohio corporate law currently gives management excessive protection that discourages investment in Ohio. Further, Ohio corporate law may have reached an impasse. By failing to properly address the agency problem between management and shareholders, Ohio law has increased the cost of capital to Ohio firms. Demonstrating this point is Abercrombie's recently failed attempt to reincorporate in Ohio. Simply put, the overwhelming weight of theoretical and empirical evidence indicates that Ohio should revise its corporate law and securities regulation to facilitate investment in Ohio.

Nonetheless, the difficulty in reforming Ohio corporate law and securities regulation may be a practical issue more so than one based upon intellect and reasoning. Local attorneys as well as management can have interests in maintaining extreme and complex corporate law. Investors, on the other hand, are not likely to be vocal in Ohio government because they may simply "vote with their feet" and invest under other jurisdictions' laws.⁴⁶⁸ Due to dispersed benefits arising from improving Ohio corporate law, and the resultant collective action problem among Ohioans, meaningful reform may require an enterprising elected official to take a stand on the issue.⁴⁶⁹ Alas, Ohioans and their elected representatives are left to determine whether policies attracting investment capital and encouraging efficient businesses will prevail in the debate over Ohio corporate law.

⁴⁶⁸ Easterbrook & Fischel, *supra* note 18, at 1181.

⁴⁶⁹ See Kahan & Kamar, *supra* note 88, at 725 ("Even absent a change in economic fundamentals, it is entirely plausible that an enterprising governor will in the future revamp her state's corporate law, establish a specialized court, and go after a portion of Delaware's profits.").